FINANCIAL ADMINISTRATION

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INDIAN INSTITUTE OF PUBLIC ADMINISTRATION
INDRAPRASTHA ESTATE, RING ROAD, NEW DELHI-110002

1986

PRICE { INDIA : Rs. 100.00
ABROAD : £ 16.00 or $ 22.00 }

PRINTED AT REPROLET, 32 A/1 JANAKI BHAWAN
GOVINDPURI, KALKAJI, NEW DELHI-110019

Preface

Financial administration is an important component of the total system of administration as it plays an integrating role amongst the various functions of sales, production, plant utilisation, etc., in the case of business enterprise, to generate information relevant for management decision-making. In government also, financial administration runs through the different substantial areas, like, agriculture, industries, education, medical, police, etc., to relate expenditure of funds with the achievements to be accomplished in terms of various programmes, activities, operations, and tasks. Financial administration is integral not only to different tiers of government in the country but to different forms of managing the economy, be they public enterprises, departmental undertakings or private units. The positive role of the finance function in the administrative set-up is not always appreciated in a proper perspective.

Planned development makes it imperative that the administrators who are to act as agents of change should familiarise themselves with the advancement in knowledge that is taking place, acquire the modern management skills, and develop a perspective conducive to right attitudes and improved behavioural patterns. Financial administration assumes great significance in this context as most of the governmental activities have financial bearing. Financial administration is primarily related to the question as to how the limited resources can be utilised to the utmost and to achieve the maximum of national objectives. The type of budgeting system in operation, adequacy of delegation of financial powers so as to be commensurate with the responsibilities to be discharged at various management levels, the administrative culture evolved in which these powers are exercised, financial discipline observed by government, the various methods and instruments employed for ensuring financial control, fiscal policies formulated, etc., all these matter a lot in determining the quality of financial administration.

A proper understanding of these various aspects of financial administration is essential for improved performance of their tasks by the administrators. A correct appreciation of the various facets of financial administration is also important for those interested in a study of public affairs and for scholars researching into problems of public administration. Financial administration aims to create cost consciousness in administration and bring out the implications of rationality and avoidance of wastefulness in implementation. Financial adminis-

tration can be made to serve as an effective tool of administrative accountability. It can also be relied upon to act as safeguard of financial probity in administration.

The present book, in the series of Silver Jubilee Volumes of the *Indian Journal of Public Administration*, tries to cater to the felt need of practitioners and scholars to provide them with the authentic literature they should look for in a study of financial working of government. It should help widen their perspective for studying formulation and implementation of programmes of socio-economic development. The book is also intended to provide them with an opportunity to reflect on the existing financial administrative system and the procedures, their adequacy, and the reforms and improvements required to be brought about to meet the challenges thrown by development administration. It should also reorient their thinking in terms of achievement of results while managing developmental programmes and help the administrators to develop new approaches and strategies to meet managerial problems. What is important in the context of development administration is to ensure an efficient and economical use of resources and also effectiveness of expenditure in terms of achievement of the desired impact. The scientific financial administration is not only the responsibility of a few financial functionaries in the government. The worthwhileness of the management depends on its understanding of the intricacies and operations of the financial system and how it can be utilised to deepen and broaden the totality of managerial effectiveness.

Ever since we launched upon planning era, government expenditure has been increasing both in size and complexity under successive Five Year Plans for implementation of the programmes of socio-economic development. In this new context, management considerations have assumed added significance to meet the challenges posed to finance function to ensure optimum utilisation of resources. Financial administration is often construed as negative in nature and inhibitive of developmental momentum. Financial administration is really a powerful facilitating tool available to management or administrative agencies in the achievement of their goals. A sound financial administration gives operational significance to the concepts of economy, efficiency and effectiveness.

Financial administration of government can be viewed in two main components, namely, budgeting and financial control, and fiscal and monetary policies. The two components include a variety of subjects, like various types of budget systems, parliamentary financial control, delegation of financial powers, tax policies and tax administrative problems, etc. In the present volume, seventeen articles covering some important aspects of financial administration have been included by grouping these into six parts, *i.e.*, (1) Financial Control, (2) Budgeting,

(3) Financial Discipline, (4) Union-State Financial Relations, (5) Management Accounting, and (6) Audit. These articles were published in some of previous issues of the *Indian Journal of Public Administration* and were considered of more enduring value.

It may be mentioned that the full gamut of financial administration covers certain other aspects also. But, in the present volume, it has been sought to retain focus on three selected areas, namely, Financial Control, Budgeting, and Fiscal Policies and Tax Administrative Problems. The nature of the subject of financial administration is such and its scope so vast that inclusion of many more aspects of the subject in the volume would have diffused the main focus. The articles have also been chosen with a view to providing a broad appreciation of some important areas of government financial administration to even non-finance executives.

We hope that the volume would serve a useful purpose to students and administrators interested in finding authentic material on government financial administration at one place. An introductory chapter by Prof. Handa added to the volume, in addition to providing a brief sketch of financial administration, also sums up the main features of each contribution with a suitable commentary wherever considered necessary. The relevance of the articles to the present times has been indicated highlighting the suggestions contained in the articles, which have either been implemented in some shape or other or which continue to remain valid. Prof. Handa deserves our thanks for taking pains in providing a thematic unity to the articles that comprise the present volume. Our appreciation is also due to the staff of the Library of the IIPA for preparing a select bibliography on the subject which further enhances the usefulness of the publication.

NEW DELHI
APRIL 8, 1986

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Introduction

Financial administration is a part of the total process of administration and is governed by the same concepts, principles and considerations as the system of administration as a whole. In government, the two main components of financial administration are: *(i)* Budgeting and Financial Control, and *(ii)* Fiscal and Monetary Policies. For an organization, financial administration, in brief, would comprise raising of resources and their utilisation by incurring expenditure with efficiency and economy. It also implies a proper coordination of resources and expenditure through a well considered and carefully formulated budget plan.

The traditional meaning of a budget has been matching of proposed expenditure for a specified period of time with the anticipated receipts for the same period. Generally, the specified period for which budget is prepared is one year. In the case of governmental organizations and most other public authorities in India, the budget year extends from April to March.

There is, however, no concept or theory behind having budget period for one year. It is out of administrative convenience that annuality of budget period has been found more suitable. It is more than six months' effort which is put into framing and finalizing estimates for the ensuing budget year. Therefore, if a budget period is kept for less than one year, it would not be a sound proposition to put in so much effort on framing budget estimates which would be operative for less than a year or for a few months. Also, it is not administratively proper to have a budget for a period longer than one year. Because already, when we prepare estimates for a period of twelve months, it becomes necessary to revise these during the budget period, and if such a period is for longer than twelve months, more such revisions would be needed which goes against the principles of sound financial administration. Therefore, administrative convenience and necessity dictate that the budget period should be kept for one year.

Whereas the traditional approach in budgeting has been to match the proposed expenditure with the resources which an organization would be able to raise, the budget has, of late, been assigned many other meanings and connotations for it to be used for a variety of purposes. The budget is now being employed to serve diverse purposes and needs. According to Wildavsky, a budget can be:

a political act, a plan of work, a prediction, a source of enlighten-

> ment, a means of obfuscation, a mechanism of control, an escape from restrictions, a means to action:, a brake on progress, even a prayer that the powers that be will deal gently with the best aspirations of fallible men.*

The budget is presently being used as an instrument of social and economic policy to serve the three functions of allocation, distribution, and stabilisation. It is also being used as a plan of action for an efficient and economical implementation of programmes, activities, schemes, and projects.

For a government department, obtaining resources is done through the budgetary process by presenting demands for grants to the legislature. There are four stages in review and approval of the budget by Parliament : (*i*) general discussion on the budget, (*ii*) discussion and voting on the demands for grants, (*iii*) passing of the Appropriation Bill, and (*iv*) passing of the Finance Bill. In the case of a public undertaking, its resources are obtained from equity and loan capital, generally contributed by the government. Its resources also comprise of its own earnings, and in some cases, subsidies received from government and deposits procured from public if permitted by the government.

A capital expenditure proposal of a public undertaking is required to be approved by the government before its incorporation in the budget. There are, however, limited powers delegated to a few public undertakings making some exceptions in this regard. No prior approval of the government is necessary to the budget proposal of a public undertaking if its revenue expenditure is to be met from its own earnings or revenues. But, prior government sanction would become necessary if the public enterprise proposes to obtain loan from government to make good any deficit in its revenue expenditure. There are two high powered bodies constituted within the government machinery for considering expenditure proposals for approval and sanction of the government. An Expenditure Finance Committee examines proposals involving expenditure between Rs. 5 crores and Rs. 20 crores. There is a public Investment Board responsible for scrutinising expenditure proposals pertaining to schemes and projects costing more than Rs. 20 crores.

Another aspect of financial administration in government is that the departments are required to utilize resources within the scope of the grant as voted by Parliament and as provided for in the budget.† It is

* Aaron Wildavsky, *The Politics of the Budgetary Process*, Boston, Little, Brown and Company, 1964, p. v.

† In the Indian Constitution the mention is that of Annual Financial Statement which is known as the budget.

the approved budget which provides the necessary authority to the government departments for spending money from the consolidated fund. In the case of a public undertaking also, it is the budget as approved by its Board of Directors, subject to the various controls exercised by government, which provides authority for spending money on its various programmes and activities.

In the case of public undertakings there are various areas in which control is exercised by governmental agencies and other authorities, and also there are certain methods employed for the purpose. Original investment decision to set up an enterprise is taken by the government. And, initial worth of a public enteiprise including its subsidiaries is to be approved by the government. Also, capital structure of a public enterprise involving decisions on debt-equity ratio requires approval of the government. Subsequent modifications, alterations, expansion, or restructuring of its capital by a public enterprise also need prior approval of the government. In certain cases, pricing of the products of a public enterprise requires prior approval of the government. Also, government exercises financial control over emoluments structure of a public enterprise by regulating wages and salaries, and requiring government's prior approval to any revisions by a public undertaking of its wage and pay structure.

These controls over public undertakings are exercised by the administrative ministry, the Ministry of Finance, Planning Commission, and the Cabinet. Audit is an important tool of financial control. Audit reports are used by the Parliament's Committee on Public Undertakings to review the operations and performance of a public enterprise. The Committee may also do so on the basis of the studies and investigations undertaken by itself. There are Audit Boards constituted under the Comptroller and Auditor General for evaluating the performance of public enterprises.

There are a variety of methods employed by government to secure proper functioning of public undertakings. Government generally tries to ensure that a senior person incharge of financial management is appointed by the public enterprise to look after its finance function. It further requires that the public enterprise should clearly specify the cases where financial concurrence is optional, mandatory, or is not required. Government also nominates its officers to represent it on the Board of Directors of public undertakings. There are also quarterly performance review meetings held by the administrative ministries to review the performance of public undertakings falling under their administrative control.

In a government organization as well as in a public undertaking, the transactions taking place both pertaining to receipts and expenditures have to be recorded in accounts according to the prescribed

classification. There are different types of accounting systems adopted for recording transactions and generating information therefrom, which are, financial accounting, cost accounting, and management accounting.

Financial accounting is the method for recording events and transactions, expressed in monetary terms, in appropriate books of the enterprise. It involves collection, classification, summarization and communication of financial data. In the case of a public enterprise or commercial organization, the communication of financial information is done for the purpose of indicating the true state of affairs of the enterprise at a particular point of time, which is done through balance sheet. It is also done to convey what loss or gain accrued to the enterprise during a particular period of time, which is done through profit and loss account. In the case of government departments, financial accounting helps in providing data for preparing budget estimates, for exercising budgetary and exchequer control, and to facilitate financial audit to ensure legality and regularity of expenditure.

Cost accounting aims at measuring the use of resources, expressed in monetary terms, related to a purpose. It enables to know the cost of a function, activity, operation, job, process, product, etc., so that cost can be controlled. It also helps in taking a variety of management decisions, such as, pricing a product, whether to make it within the firm or buy it from outside, nature of product mix, profit planning, etc.

Management accounting seeks to provide the necessary assistance to various management levels in the organization hierarchy by generating, and supplying to them, information which can be of help in their specific management functions and decision-making needs. Management accounting generates information by collecting, processing and analyzing proper data having bearing on the decision-making proposition. It makes use of the relevant techniques and tools for the purpose of generating the required information to facilitate decision-making in the discharge of various finaneial management functions of planning, programming, budgeting, monitoring, and review. Management accounting generates information by the application of the relevant concepts and techniques to the historical and projected economic data of an enterprise. It is multi-disciplinary and depends for information on sources, which are, financial accounts, cost accounts, and sources other than accounts.

An important aspect of financial administration is the exercise of necessary control to ensure that expenditures are incurred on the programmes, activities, schemes, and projects, as approved by the legislature and in accordance with the scope of the demands as granted by it. It is also to ensure that money is spent after obtaining the sanction of the competent authority and by observing the various rules, regulations, codes, and manuals. Budget is used as a mechanism to

facilitate such a control.

Audit is another important instrument for exercising the necessary control to ensure accountability of the Executive towards the Legislature and within the Executive of the spending agencies towards the sanctioning and controlling authorities. There are different types of audit, such as, internal audit, management audit, statutory audit under company law conducted by certified Chartered Accountants, and statutory audit by the Comptroller and Auditor General of India (in some other countries, referred to as Supreme Audit). There are also different approaches adopted in these various types of audit, such as, ensuring correctness and completeness of accounts, regularity audit, propriety audit, cost audit, efficiency-cum-performance audit, systems audit, and social audit. At the post-budget stage, a number of legislative committees, such as, Public Accounts Committee, Estimates Committee, Committee on Public Undertakings, review government expenditure. In such a review, audit reports are used as the principal documents to provide the needed information to these Committees.

It needs hardly emphasis that public expenditures should be planned effectively so as to produce the desired impact. The assessment of such an impact is to be done not only at the point where the expenditure is incurred but also at points where the effects of the expenditure are carried. The success of a rural electrification project is to be judged not only by the generation capacity created but also by the number of agricultural pump sets energized and the hectares of additional irrigation potential created resulting in increased agricultural produce. Also, the effects of investment in an electricity project need to be traced to the promotion of small industries, and the facilities it provides for domestic and street lighting.

Therefore, in appraising a project, its financial analysis to assess the return on investment to be obtained by the project authority alone is not sufficient. It is also necessary to examine the project from the point of view of social return it would yield or the impact it would create. This is particularly important in the case of infrastructural projects or for investments made in the area of social and community services. This would, of course, take us to the problem of evolving proper and acceptable indicators of performance to assess the impact of an investment. These indicators of performance may be in economic terms, like unit cost of production or service, or these may be social indicators, such as, reduction in the incidence of a disease, or these may be in some other quantified terms, like the number of students imparted the desired education.

In any case, the measures or indicators of performance to assess the impact of an investment should be evolved so as to be acceptable to the various parties concerned with the evaluation of the project. These

parties should include the project authorities whose performance is to be evaluated in terms of such performance indicators, the administrative authorities who are concerned with overseeing the performance of the project, and the reviewing authorities including Audit who are to carry out an independent and objective assessment regarding performance of the project. It may be a difficult job but it is not impossible if the necessary 'will' is there among the various parties concerned and concerted effort is made to evolve proper indicators of performance to assess the impact or effectiveness of an investment in a scheme or project.

In this context, application of the technique of social cost-benefit analysis becomes relevant in preparing feasibility study for a project. Its application is important so that, later on, as the project is installed and commences operation, evaluation of its performance can be done against the guiding frame of the feasibility report by using the decision criteria of Net Present Value, Benefit-cost ratio, or Internal Rate of Return as considered suitable. Social cost-benefit analysis would enable a comprehensive appraisal of a project including its financial analysis and its spill-over benefits and costs occurring by way of its economic, social, and environmental impacts. It would involve identification and bringing into the project analysis indirect benefits and indirect costs, referred to as externalities, and also intangibles, in addition to direct benefits and direct costs to accrue to the project authority itself.

The deployment of resources on a project, decided on social cost-benefit considerations, needs further to be optimized by implementing the project with utmost efficiency and economy. The attempt should be to achieve the best possible input-output relationship. The physical accomplishments as related to the use of resources should be sought to be maximized. This would emphasize the need for using the modern management techniques of network analysis and performance budgeting at the implementation stage of the project.

The technique of network analysis, which is a common term used for Critical Path Method and Programme Evaluation and Review Technique, is a method for proper planning, scheduling, and controlling the implementation of a project. It helps greatly in completing a project within the minimum necessary time and thereby enables controlling the cost of the project to optimize the use of available resources.

Performance budgeting is another technique which helps in achieving efficiency and economy of expenditure. It is of significant help in preparing a proper plan of action and comparing against it the actual implementation of programmes, activities, and even specific operations and tasks. The Government of India, since 1968, has been trying to implement a scheme of performance budgeting in most of its depart-

ments. Many state governments have also been trying to do the same in their selected departments. And also, a good many public undertakings have either introduced performance budgeting or are in the process of adopting such a system.

Traditionally, it is line-item budgeting which has been used in India. Such a system of budgeting works all right when the public expenditure is incurred mostly on general administration type of activities, namely, collection of revenue, maintenance of law and order, etc. In such a case, the expenditure proposed to be incurred by an organization can be identified only in terms of end items or objects of expenditure, like salaries, wages, travel expenses, tools and plant, materials' purchase, office expenses, etc. Since the organization is not engaged in executing any specific schemes or activities, the expenditure provided for in its budget cannot be grouped to relate to definite programmes or schemes. When such is the pattern of expenditure of an organization, *i.e.*, on general administration, its budget classified in terms of end items or objects of expenditure facilitates securing financial control to ensure regularity and legality of expenditure in terms of allotments, sanctions, rules and regulations. But when an organization is spending bulk of its budgeted expenditure on specific programmes, schemes, projects for socio-economic development, management oriented concern to relate expenditure to be incurred with the physical accomplishments to be achieved assumes greater significance. This is so in the case of most of our departments and agencies which are engaged in implementation of developmental programmes and schemes ever since we launched upon the planning era.

Whereas the concern of ensuring legality and regularity of expenditure, which is secured best by the use of line-item budgeting, continues to be necessary, it can be secured by lower levels of management in an organization hierarchy. In exceptional situations, however, higher management levels may also devote their attention to such like concern. But the management oriented concern to ensure achievement of physical accomplishments commensurate with the expenditure incurred is of intimate interest to all management levels in the organization hierarchy including the top most levels. Such a concern would best be served by the use of performance budgeting.

A performance budget is an annual plan of action in which a proper correlation is established for each programme and its components, between the use of resources translated into cost and the corresponding physical output. Such a correlation established between financial and physical aspects of the various programmes and activities is used as a guiding frame against which the actual achievements are compared and evaluated as the budget is operated upon. A periodical review of performance assumes great significance in this context. A

sound system of management accounting would be an important complement in operating a scheme of performance budgeting. A system of management accounting should first generate the necessary information for preparing a performance budget, and later, it should collect information regarding actual achievements to be compared with the budget plan of action for analyzing the deviations between the two. Such an analysis of the difference between the actual and the planned achievements, called variance analysis in commercial parlance, would help identifying the factors responsible or the reasons for such a deviation, which can provide useful information to the concerned management level for taking the necessary corrective action to remedy the situation if things are going awry.

The working of a scheme of performance budgeting would necessitate use of norms, standards, yardsticks, and units of measurement, to relate the use of resources to the targets to be achieved. This would require that the resulting output of an activity is quantifiable or countable. Whereas these norms of performance should be scientifically evolved, they should also be realistic and specific to the situation where they are sought to be applied. Evolving proper norms of performance to relate expenditure to be incurred to a quantified output to be achieved is the crux of the whole scheme of performance budgeting. This is an area in which sufficient progress has not been made for operating a system of performance budgeting in government.

Another important feature of a scheme of performance budgeting is delegation of financial powers. The various management levels in an organization can achieve the time bound targets assigned to them provided they are equipped with the necessary facility of delegation of powers which should be commensurate with the responsibilities to be discharged by them. In the Government of India, schemes have been introduced liberalising delegation of financial powers. Starting with the delegation scheme of August 1958, enhanced powers have been delegated to the administrative ministries/departments and executing agencies through the delegation schemes of June 1962, October 1968, April 1975 and January 1978. Whereas adequate delegations commensurate with responsibilities are essential, it is equally important that the necessary environment is created and the required support is provided to facilitate exercise of these delegations. The multiplicity of rules and regulations which exist in government need to be simplified and rationalised so that the delegates can conveniently observe these while exercising their powers. The scheme of Integrated Financial Advisers introduced by the Government of India during October 1975 provides for a high level functionary to be available to a ministry or department for rendering expert advice in financial matters. His presence in a ministry or department should facilitate exercise of delegated powers.

There is another system of budgeting called planning—programming—budgeting system (PPBS) which treats budgeting as an allocative process based on analytical studies, like cost-benefit analysis, for allotting funds to the best programmes amongst the various alternatives available for achieving a particular objective. There is still another system of budgeting known as Zero-Base budget which emphasizes that the budget making for the ensuing year should be started from ground zero instead of treating the current budget as the base or the starting point. Zero-Base budgeting requires a complete re-examination of all programmes and activities afresh instead of following the incremental approach to budgeting.

In the following articles, some important aspects of financial administration have been covered by various authors within the broad areas of Financial Control, Budgeting, Financial Discipline, Union-State Financial Relations, Taxation, Management Accounting, and Audit.

FINANCIAL CONTROL

The first article "A Profile of Financial Administration" emphasizes that Parliamentary control of national finance is basic to a democratic form of government, which ensures accountability of the Executive to Parliament. It was in the United Kingdom that parliamentary supremacy first came to be acknowledged by the acceptance of two principles; first, that no tax could be levied without the authority of law made by Parliament and no money could be appropriated without its specific approval. To check the appropriations from being diverted by the government to purposes other than those intended by Parliament led to the gradual evolution of another principle that estimates should be prepared for each Vote separately and that reappropiiations were not permissible to be done by the Executive from one Vote to another. Any saving in a Vote had to be surrendered to the Exchequer at the end of the year and any anticipated excess in a Vote had to be covered by prior parliamentary approval. To make these provisions effective a Consolidated Fund was constituted into which shall flow every stream of the revenue and from whence shall issue the supply for every public purpose. It may be observed that the same very principles are embodied in the Indian Constitution and are reflected in our budgetary process.

To ensure that the Executive were observing these principles faithfully an office of the Comptroller and Auditor-General was created for the audit of public accounts. This functionary was made independent of government and accountable to Parliament. Initially, the role of the Comptroller and Auditor General was mainly confined to checking the accounts and the correctness of classification of expenditure to

ensure that the grants had not been exceeded and the expenditure was incurred within the scope of the grant and on the purpose as authorized by Parliament. However, later, with the encouragement provided by Parliament, the Comptroller and Auditor General started looking into and reporting on the wisdom, faithfulness and economy of expenditure. The taking up of this additional function by Audit made it an effective instrument of parliamentary financial control.

The author traces the origin of the Public Accounts Committee of Parliament to the need for examining reports submitted by the Comptroller and Auditor General. It was thought that the audit reports required a detailed examination of a somewhat technical character, which could best be done by a select committee of Parliament. The Public Accounts Committee thus came into being and soon became a powerful instrument in the control of public expenditure.

The author refers to a novel feature of the Indian Constitution in creating a Public Account which does not exist in the UK system. This account includes receipts other than revenues, such as deposits made by private parties, provident and other fund balances, premia on postal life insurance, postal savings bank balances, etc. The amounts comprising the Public Account are held in trust by government and repayments of these by the Executive does not require authorization of Parliament. The author considers that though there is nothing wrong in having such an account, the way balances in the Public Account are treated comes in the way of applying effective parliamentary financial control over withdrawals from the Consolidated Fund.

It is stressed by the author that the redesignation of the Auditor-General as Comptroller and Auditor General by the Indian Constitution envisaged a system of exchequer control which function has not developed in India. He, however, recognizes that exchequer control cannot be exercised unless there is a single source of funds and all payments are made centrally from this fund.

The author also mentions about the irrationality in retaining the accounting function with the Comptroller and Auditor General. It may be observed that the accounts have since been separated from audit and departmentalised so far as the Union Government is concerned; which process was completed for all the departments by October 1976.

The author has made a pertinent reference to delegation of powers staying at the level of the administrative ministries/departments and further redelegations not taking place down the line to all executive levels. It may be stated that whereas the point made out by the author is valid, efforts have continued to be made to ensure that such redelegations do become part of the system of decentralised financial control.

In the article titled, "Expenditure Control in a Development Administration", (p. 68) the author states that the subject of expenditure

control in a 'Development Administration' needs to be treated differently from that in a 'Law and Order' Administration. According to him there are certain people like some impatient technocrats who do not like any sort of financial discipline. For, an enthusiastic technocrat may tend to go in for expenditure beyond the dictates of prudence. And, if he exercises financial prudence and is not enthusiastic he may not inspire others. Therefore, there is need for a combination of two persons, a spender and another who exercises prudence.

Physical planning should be matched by monetary planning. In a developing economy, there is great need for involvement of financial officers and advisers who should function under the control of the Chief Executive of the Organization. However, in the event of difference of opinion between the finance officer and his superior, there should be a mechanism whereby both the views are placed before the minister or the top man concerned.

The author also remarks that there are too many rules which are too detailed with a variety of instructions under them. It is this multiplicity of financial rules which creates friction between Audit and Executive authorities. There is need, therefore, for reformation and simplification of rules.

The author of the article, "Financial Control over Expenditure in the Central Government" (p. 49) states that the financial rules of the central and state governments postulate that the financial powers of government which have not been delegated to any other department or authority vest in the Ministry of Finance/Finance Department. This provision is derived from the codes that were in force prior to the reforms of 1935 and which applied both at the centre and the states. It is now deemed to have been made under Articles 77(3) and 166(3) of the Constitution which authorize the President and the Governors to make rules for the convenient transaction of the business of the Government of India and the Governments of the States.

The author remarks that the delegations to administrative departments and subordidate authorities, which were limited in scope served the purpose all right so long as the bulk of government expenditure was on functions of law and order, and defence. But after adoption of the policies of a Welfare State and launching upon planned development, the speedy and efficient execution of schemes and projects have brought to the fore the problem of removing bottlenecks and bringing about improvements in public administration. Whereas the need is recognized for the departmental secretary to have individual responsibility for the efficient and economical administration of his charge, he needs to be assisted in the discharge of his various functions by an Internal Financial Adviser working under his administrative control and as part of his department. The specialised knowledge possessed by the Finance

Wing of his department would help him in introducing cost consciousness and making a positive contribution to the various decisions having financial bearing.

BUDGETING

The first article in this part titled, "The Theory of Budgeting and Government Organization" (p. 12) highlights the importance of the subject of budgeting because it is intimately related to the policies that are finally adopted by a country. However, the author maintains that budgeting, as traditionally practised, is not very suitable for policy-making. The traditional budgeting is conducted in a form that is meant to ensure legality and regularity of expenditure. The normal classification of such a budget is in terms of expenditure on items, like salaries, travel expenses, office furniture, postage and telephones, etc. Such a budget might have been quite suitable for a stable society engaged in routine activities.

A modern government is engaged in four main types of activities, namely: (*i*) defence, (*ii*) development, (*iii*) welfare, and (*iv*) maintenance of law and order. One of the major problems of budgeting for a government is to make allocation of the available resources among these four categories of activities. It is clear that the traditional method of budgeting in terms of departments and items of expenditure is not suitable.

In a modern budget while deciding whether enough money is being allocated to welfare covering matters such as public health. education, etc., it is necessary to have some quantitative ideas about what benefits in terms of end-results are derived from these operations. The traditional classification of expenditure in terms of the employees of a public health department would not tell you anything about the extent to which cholera and malaria is being reduced in India. In a modern budget, it is found necessary to provide substantive information about how much malaria control is to be obtained from a particular amout of expenditure to be incurred. Therefore, in modern budgeting, which the author calls programme budgeting, what is required to be emphasized and highlighted is, how much benefit in a meaningful sense is achieved from expenditure.

A budget is the plan of action of government for the ensuing year. At the stage of budget formulation, therefore, one has to be more specific about the objectives involved in a programme and be concerned with the question of cost-effectiveness to ensure that the money spent would accomplish the best results and achieve the maximum benefit. It also becomes a moot point to examine whether the total benefit of the budget is worth the cost that it imposes on the Indian economy? It

is pertinent to know whether the country is going to benefit from the budget to such an extent that it is worth the taxes? It would serve a useful purpose if a comparison is made between the benefits from expenditure and the burden from taxation.

The article. "Two Aspects of Budgeting" (p. 171) stresses the point that the annual budget (or short-range plan) and the longer-range development plan are complementary to each other and should be treated as such. In countries where: (*i*) the preparation and execution of the budget. and (*ii*) the formulation and supervision of the development plan, are the responsibilities of different agencies, it is imperative that the highest level of coordination is achieved between these agencies. The relationship between planning and budgeting is of crucial importance in modern government for establishing and achieving common goals.

According to the author, long-range planning without regard for the realities of annual budget implementation is an academic exercise of little operational value. And also, budget making which does not consider the coordinated needs of the development plan tends to fragment the energies of the nation and retards progress toward rational objectives. Therefore, while preserving the separate vocational identities of planners and budget makers, it is important to achieve an ultimate fusion of planning and budgeting if the government is to achieve its goals and objectives. For the purpose, it would be necessary to maintain close and continuous working relationships between personnel engaged in planning and those in budgeting. It would further be necessary to employ uniform and agreed upon terminology, concepts, and classifications in both the planning and budgetary process.

The author also stresses that the development plan and the annual budget should be formulated in both financial and physical terms wherever possible. The budget process provides a systematic means of communicating needs upward and policies downward throughout the government. These needs and policies are required to be reconciled at each level in the management hierarchy. It is, however, necessary to have a strategically located central budget agency to coordinate the entire process. This central agency should review budget proposals of the various ministries/departments in the light of economic, social, political, financial, and administrative policies of the government.

Performance budgeting, the author states, can be an extremely valuable tool for the guidance of policy makers because it helps developing data and information in a form which is useful for decision-making. However, installation of a system of performance budgeting requires much work and study over a fairly long period of time. Standards and norms of performance can be evolved only after considerable analysis and understanding of programmes. Also, these norms, standards,

yardsticks, unit costs, need to be reviewed periodically and re-evaluated on the basis of changing conditions. By establishing correlation between physical progress and the use of resources, performance budgeting can provide useful measure to evaluate success of a programme.

The author of the article titled, "Performance Budgeting in India—A Review of the Developments, Present Status and Prospects" (p. 19) states that the budgetary system in India had been designed and developed mainly to facilitate financial and legal accountability of the executive to the legislature, and within the executive, of subordinate agencies to the controlling authorities. Accordingly, the budgets emphasized the financial aspects and did not interrelate financial outlays with physical targets and achievements. The various documents supporting the budget did not provide information on What the Government was doing, how much it was doing, at what cost, and with what results.

In the context of planned development and the growing size and complexity of governmental activities, it was becoming increasingly clear that there was need to reorient our budgetary system. Performance budgeting was adopted as it was thought to remedy the defects of the traditional system by correlating the financial and physical aspects of each programme and activity.

The author points out that performance budgeting even though introduced in various departments did not really become an operative scheme. He finds that the position was not very encouraging if one considered the extent to which the departments had made use of performance budget for control, and had initiated necessary measures for streamlining their financial and work procedures, and evolved suitable work units and work measurement techniques, and installed management oriented information system.

The author has stressed in his article that since performance budget has to be built up from below and not imposed from above, it is necessary to make massive efforts in training and orienting top, middle, and lower level officials.

The article titled, "Budget Management Techniques: A Perspective for India" (p. 33) discusses the various types of budget systems and examines their suitability for application in India. The author points out that the historical origin of a budget was for purposes of exercising control to ensure regularity and legality of expenditure, for which a line-item budget was adopted. This evolution of the control oriented budgetary system was followed by developments, in recent decades, to use budget as a tool of management for an efficient and economical use of resources for the implementation of governmental programmes and activities. For the purpose, performance budget had been adopted.

A further addition to these budgetary concepts has recently been in treating budget as an instrument for planning an effective use of resources for achieving the objectives of government.

A number of budgeting techniques have been evolved to achieve diverse purposes, and are being used with varying degrees of success in different countries. These include: line-item budgeting, performance budgeting, programme budgeting or planning—programming—budgeting system (PPBS), Zero-base budgeting (ZBB), sun set legislation, etc. In the present article, the author examines the feasibility for the application of these techniques in the conditions obtaining in India.

Performance budget correlates the physical and financial aspects of each programme and activity by establishing a proper relationship between outputs and the corresponding inputs. The author states that performance budgeting has great potentiality to be used in India as a tool of management for an efficient and economical implementation of governmental programmes and schemes. The system envisages selection and development of suitable work measurement units, norms, yardsticks, standards, and other performance indicators for measuring the physical quantum of the work proposed to be done or services to be rendered.

Another area requiring attention is the accounting classification adopted by the government, which should be such as would adequately serve the objectives of performance budgeting. Government accounting is done on cash basis which makes it difficult to know the entire cost assignable to an activity. The accounts classification is not designed to relate to cost centres. Hence, it is difficult to allocate cost to a responsibility centre and to evaluate actual cost against standard cost. The new classification of accounts in terms of functions, programmes, activities, etc., therefore, needs to be improved further to provide for a subsidiary set of accounts to correspond to cost centres and to facilitate responsibility accounting. Among the various important issues to be resolved satisfactorily for a successful operation of a scheme of performance budgeting is also "delegation of financial powers". Whereas adequate delegations commensurate with responsibilities are essential, it is equally important that a proper environment and the necessary administrative culture are created to promote and facilitate the exercise of these delegations. A performance budget is a work plan which expresses targets for achievement in respect of various responsibility levels, based on accepted norms and standards. In this context, designing a meaningful information and reporting system assume vital importance.

Programme budgeting or PPBS emphasizes the planning aspect of budgeting for selecting the best out of a number of available alternatives, and for optimizing the choices in economic terms while allocating funds in the budget.

The basic feature of a zero-base budget is that the departments, while preparing their budgets, should not take anything for granted and, therefore, should start on a clean slate. The budget making for the ensuing year should be started from ground zero instead of treating the current budget as the base or the starting point. The concept of zero-base budgeting implies that all activities of the organization should be viewed afresh and priorities among competing claims for allocation of funds settled on the basis of some analytical evaluative techniques like cost-benefit analysis.

Sunset legislation is a formal process of policy review for terminating programmes not desired. It embodies the concept of self retiring government programmes by providing for the termination of the statutory authorisation of programmes. This is achieved by placing time limits on government programmes in the legislative enactments themselves and providing for their automatic termination on the prescribed dates unless affirmatively recreated by the legislature after conducting a detailed review.

The author states that programme budgeting or PPBS, and zero-base budgeting are not feasible for application in India because both these techniques require planning, based on analytical studies, to be made an integral part of the budgetary process for deciding on allocation of funds. This, for various reasons, is difficult to be achieved in a democratic political set-up as it obtains in India. The author recommends a system of periodical review of programmes/schemes/activities, etc., based on zero-base concept instead of annual review. The system of sunset legislation is also not feasible in India because of certain basic differences, constitutional and others, between the position and powers of the Indian Parliament and the United States Congress.

FINANCIAL DISCIPLINE

The author (p. 81) in his article, "Financial Discipline for Union and State Governments" refers to the expression 'financial discipline' which had come into vogue since the economic crisis which was developing during the previous four years ended in the devaluation of the rupee at mid-night of June 5, 1966. This implied that the Union and state governments had failed to exercise discipline in the past. That every year the budget should be balanced is obviously the first step in financial discipline. The author quotes the official view that it would be necessary to introduce fresh measures of economy in expenditure, improve the performance of our projects so that an adequate increase in output is obtained from investments already made, and to undertake fresh investment only to the extent that genuine savings are available to finance them. These measures implied a rigorous discipline on the part

of Central and state governments alike.

The author maintains that it is altogether objectionable that revenue deficits should be made up by Capital receipts. According to the author, effective financial discipline on the part of the Central and state governments involves: (*i*) balancing the revenue and capital budgets separately, including in the revenue budget recurring items of unproductive capital expenditure, (*ii*) non-resort to further indirect taxation, (*iii*) a tight grip over non-development expenditure, (*iv*) strict economy in new development expenditure, (*v*) insistence on all investments in irrigation, power, mining and industry being fully productive, and (*vi*) borrowing only from personal and institutional savings.

UNION-STATE FINANCIAL RELATIONS

The first article in this part is on "The Finance Commission and Union-State Relations in India" (p. 87). The author describes the establishment of Finance Commission, for which provision is made through Article 280 of the Constitution, as a unique institution and India's original contribution to the theory and practice of federalism. According to the author, the appraisal of the principal recommendations of the three Finance Commissions, which had preceded, showed clearly that the Finance Commission had taken due note of the growing inadequacy of the resources of the states, particularly in relation to planning, and their increasing dependence on the Centre for financial assistance.

The financial assistance which the states receive on the basis of the recommendations of the Finance Commission is of a statutory character and does not involve Central control over its utilisation. Accordingly, it does not affect the autonomy of the states. It must, however, be conceded that the Finance Commission can offer the states only partial protection against Central encroachment in their sphere of autonomy. A large part of Central assistance in relation to the Plans comes to the states in the form of loans and grants under Article 282 of the Constitution. The so-called 'Plan Grants', which the states cannot refuse unless they are prepared to forego the benefits of development, make the states vulnerable to Central control.

The article titled, "Centre-State Financial Relations" (p. 101) states that as both the Planning Commission and the Finance Commission are engaged in the apportionment of the financial resources to the states, their functions "have tended to overlap at many points" and "it has created not an inconsiderable amount of confusion in the criteria adopted in determining Central assistance". This dichotomy has led to many conflicting results; (*i*) The estimates submitted by the state governments to these two bodies are not consistent because in order

to squeeze more from the Finance Commission which is engaged in filling the revenue gap through statutory grants, the states are tempted to present underestimated figures of their resources; (*ii*) in the process some wealthy states fudge the figures; (*iii*) the distribution between the plan and non-plan expenditure is false; and (*iv*) a major contradiction and irrationality in the functioning of these two bodies arise because the datum used is different. Hence they act at cross purposes.

The author emphasizes that the need is to allay the apprehensions of the States that they are subordinated, and to make them financially viable in order to cope with the growing societal needs. The apprehensions can be allayed by changing the discretionary nature of the Central assistance. This can be achieved by enlarging the scope of the Finance Commission by making it responsible for giving grant for both plan and non-plan expenditure. This can be effected by simply making the terms of reference of the Finance Commission, under Article 280(3) (*c*) more comprehensive as has been suggested by the Administrative Reforms Commission. For this the appointment of the Finance Commission should be synchronised with the launching of the plan.

TAXATION

The author in his article, "Indian Tax Structure" (p. 124) emphasizes that the state governments in India are at a disadvantage in tax matters as compared to the Union Government. Firstly, the important indirect taxes of the Union Government, such as union duties of excise, are camouflaged with the price. As a result, the consumers do not know the exact amount they are paying by way of taxes. The indirect taxes of the state governments, such as the sales tax, are shown separately and the consumer knows it specifically. Hence, the consumer realises their incidence immediately. This invites more resistance from him. Secondly, the direct taxes of the states, such as land revenue and agricultural income tax, impinge directly on the majority of population who play an important role under the right of adult franchise whereas the direct taxes of the Union Government, such as the income tax and corporation tax, affect only those segments of the society which constitute a small political minority.

The Union Government has, therefore, found it easy to increase the tax load on these sectors whereas the state governments have hesitated to tax the agricultural sector. It is, therefore, necessary that additional resources should be raised from the agricultural sector to ensure equity in taxation and to accelerate the pace of economic development.

The author of the article titled, "Taxation Policy and Tax Administrative Problems" (p. 144) emphasizes that there should be a measure of stability in the provisions for the levy of income tax and corporation

tax. This would help the corporate sector in planning its modernization and expansion programmes on a long-term basis; it would equally help the individual to assess his commitments over a longer period than a year and organize his financial affairs accordingly.

The author suggests that it may well be necessary to amend the Constitution to transfer agricultural income tax to the Union List with the proviso that the collections would be distributed to the States on the basis of their origin. Government could introduce a scheme whereby, if a person saves 25 per cent of his income in recognized deposits and investments, the whole of the amount should be exempted from tax. It may be mentioned that the present day income tax laws provide for exemption from tax of savings from income, within certain limits, which are put in recognised deposits and investments.

Another article of this Part is on "Social Objectives and Tax Policy in India (p. 131)". The author states that tax effort under the Plans has largely been hitting the poorer consumers more than any other classes. Whereas the taxes aimed at the poor hit them much harder than it meets the eyes, the overall burden on the rich has been much lighter than it appears on the surface. These realities have undermined the efficacy of taxation as an instrument of levelling inequalities in income and wealth in India.

It is the incentives, allowances, and exemptions provided which leave the necessary loopholes for tax avoidance. One way of plugging the loopholes and sealing the leakages is by eliminating all the elements of inducements in the tax laws, and in presenting them as direct subsidies on the expenditure side of the budget in conformity with the shifting priorities of the government. Apart from simplicity, such a scheme would be relatively free from loopholes and areas of discretion.

MANAGEMENT ACCOUNTING

The article titled, "Management Accounting in Government" (p. 200) deals with various aspects of the subject. The author states that a proper planning and implementation of the budget would enable optimising the use of resources and economical achievement of the organization's objectives. Management accounting can provide a highly useful service at both the stages of planning and implementation of the budget. It is based on information which can be obtained from accounts as well as on information not contained in the accounts. Management accounting also implies monitoring and evaluation of performance of the activities as compared to the budget plan both in terms of financial expenditures and the corresponding physical accomplishments. Its purpose is to provide timely information to various levels of management to facilitate decision-making at these levels for the efficient and

economical achievement of their tasks.

The revised classification of accounts and the other financial reforms already completed by the Government of India, like separation of accounts from audit and departmentalisation of accounting function, integrated financial adviser scheme, etc., should facilitate introduction of management accounting in ministries/departments to support the system of performance budgeting.

It is not possible to design any standard system of management accounting which may be applicable to all types of governmental organizations. It is necessary to evolve such a system for each department so as to suit its specific management needs. The requirements of different departments for management purposes would vary depending upon their respective functions and organisational structure. Even within the same department, management accounting system would need to be reviewed from time to time to conform to the changing requirements of the organization.

AUDIT

The first article in this Part is titled, "Comptroller and Auditor-General of India and the UK—A Comparison" (p. 154). The author states that both in India and the UK, the Comptroller and Auditor General may undertake by consent the audit of accounts of *ex offico* transactions of Public Offices in non-voted money, of semi-independent or independent bodies and certain international bodies. In the UK, the Comptroller and Auditor-General audits the accounts of the receipts of revenue and of every receiver of money which by law is payable into the Exchequer. In India, however, several important categories of revenue are still not audited. It may be pertinent to mention that the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, contains the following provision in regard to the audit of receipts:

> It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

In India and the UK details of the expenditure out of the secret service are not examined by the Comptroller and Auditor General and Parliament is content with a certificate to the Appropriation Account saying that the amount shown in the account to have been expended is

supported by certificates from responsible ministers or officers, as in India the Secretary of the Ministry concerned gives the prescribed certificate.

Both in the UK and India, the reports of the Comptroller and Auditor-General are the basis of the investigation of the Public Accounts Committee and, although they are necessarily brief, a whole year's work of the entire Department is available to the Committee.

In the UK, the Comptroller and Auditor-General is not responsible for auditing of accounts of public Corporations and therefore he has no access to the relevant books and makes no report on their accounts. His advice to the Committee on these accounts is therefore necessarily restricted and often the Committee have to depend upon themselves for the examination of such accounts. In India too, the Comptroller and Auditor General is precluded from auditing the accounts of some of the Corporations or statutory bodies and the Committee of Public Accounts have to proceed on the basis of the audit reports submitted by the Commercial auditors whom the statutory Corporations may have appointed as their auditors.

The author further states that no procedure has yet been devised whereby, as in the UK, the Comptroller and Auditor-General in India has been vested with control over the issues from the Consolidated Fund. The responsibility for drawing the money from the Reserve Bank which maintains the Consolidated Fund on behalf of the Government of India and for watching the progress of expenditure is laid down on the authority administering a grant. When the Appropriation accounts are drawn up at the end of the year, then only the Comptroller and Auditor General is in a position to know whether any authority has exceeded the grant, or whether the Government as a whole have drawn in excess of the sum specified in the Appropriation Act from the Consolidated Fund of India.

The next article in this Part is titled, "The Comptroller and Auditor-General and Public Enterprises in India" (p. 185). The author states that the efficiency and economy with which public enterprises in India are managed naturally concern all of us. Of equal importance is the need for an impartial body to judge their working and to report on their achievements and failures. Audit is one of the important instruments of control and accountability, and more so when put in the hands of an independent public authority—the Comptroller and Auditor-General (C&AG).

The organizational pattern broadly governs the type and method of audit in Indian public enterprises. If they are run departmentally like the Chittaranjan Locomotive and ordnance factories, the accounts are subject to conventional government audit. The accounts of the enterprises registered as Government Companies are audited by professional

auditors (Chartered Accountants) appointed by the Central Government on the advice of the C&AG.

The author states that a good deal of the criticism of C&AG audit arises because it is claimed to be an efficiency-cum-propriety audit. For this purpose, it probes into the decisions taken by the Board of Directors. Even assuming that it is proper for the C&AG to conduct efficiency-cum propriety audit, experience has shown that even with its modern slant on managerial assessment, audit can only look into managerial efficiency so far as it is reflected in the financial results of an enterprise's working. Audit of accounts, however, widely interpreted, is incapable of evaluating technical efficiency. Similarly, an auditor is not competent to review specific management decisions. The C&AG in India in this regard suffers from an additional drawback, *viz.*, that he does not have adequate qualified personnel. The Commercial Audit Department of the C&AG's organization is staffed largely by those brought up in government audit tradition.

In the United States, Government Corporations are audited by the Comptroller-General But there, the Corporate Audit Division of the Comptroller-General's office is largely manned by professional auditors.

The author maintains that if the C&AG's audit is to serve a more useful purpose, the need would be to strengthen its staff by recruiting persons from the profession, and giving them suitable training. Refresher courses would also be necessary for the existing staff to acquaint them with the ins and outs of the operation of state commercial and industrial enterprises.

The author remarks that what is necessary is not to do away with the C&AG's audit, but to regulate the form, content and approach of his audit so that it may be carried out with the least damage to business efficiency of public enterprises. An important change would be to lay much greater emphasis on the assessment of the results rather than on the meticulous implementation of the rules and procedures. It may be mentioned that such improvements as suggested by the author have been taking place in the C&AG's audit of public enterprises.

The last article included in the volume is on "Rationale of the Indian Financial Year" (p. 214). The author narrates the developments leading to the adoption of the present financial year of India (April to March), and traces the history of subsequent attempts for changing it. He also makes a mention of the financial years of various other countries; some of which have got changed after the publication of the article. For instance, the United States Federal Fiscal year now begins from 1st October.

After discussing the criteria for selecting a financial year for better budgeting, the author examines pros and cons of adopting the various alternative budget years suggested from time to time, that is, commenc-

ing on 1st July, 1st October or 1st November, and 1st January. He concludes that even though the financial year starting from 1st of April is not based on the customs and needs of our Nation, it has come to stay because no alternative budget year is acceptable to all the states of India. Different states of India view differently the suitability of various alternatives to their respective climatic and other conditions. It is extremely difficult to reconcile the interests of all the states to any one alternative budget year. It is, however, accepted by all concerned that we should have a uniform budget year both for the Union and the states. In the circumstances, therefore, the author maintains that the best course would be to retain the existing financial year.

It may be stated that the L.K. Jha Committee had recently recommended adoption of budget year commencing from 1st January. But the Government of India have decided to retain the existing financial year beginning 1st April.

K. L. Handa

Contents

A Profile of Financial Administration

A.K. Chanda

PARLIAMENTARY CONTROL of national finance is basic to a democratic form of government. It is by controlling finance, parliament controls the executive and secures their accountability.

Parliamentary supremacy came first to be acknowledged in the UK when the King's government was forced to accept the two principles that no tax could be levied without the authority of law made by parliament and no money could be appropriated without its specific approval. While the acceptance of these principles curbed the arbitrary exercise of taxing raised. Having obtained the appropriations, the King's government often diverted them to purposes other than those intended. This led to the gradual evolution of the principle that estimates should be prepared for each departmental vote separately and approved by the Treasury before presentation to the House and further that individual appropriations could not be varied by the executive by reappropriating moneys from one vote to another. Any anticipated excess in a vote had to be covered by prior parliamentary approval; similarly, and saving in a vote had to be surrendered to the Exchequer at the end of the year.

To give reality to these provisions, a Consolidated Fund was constituted into which shall flow every stream of the revenue and from whence shall issue the supply for every public purpose. A Contingency Fund was also authorized to enable the executive to meet unforeseen expenditure during the recess of parliament, subject to the fund being reimbursed by a vote of parliament when it reassembled.

Having laid down principles, parliament found itself in the unenviable position of not being able to ascertain whether the Executive were observing these principles faithfully. Eventually, a solution was found by creating the office of a Comptroller and Auditor-General, independent of government and accountable to parliament for the audit of public accounts. Initially, his role was mainly to check the accounts and the correctness of classification of expenditure to ensure that the votes had not been exceeded and that amounts appropriated had been utilized for purposes authorised and within the scope of the grants. But later, with the encouragement of parliament, he assumed authority to report on the faithfulness, wisdom and economy of expenditure.

This forged audit into an effective instrument of parliamentary control.

The question then arose as to how best the audit report could be dealt with. It required a detailed examination of a somewhat technical character and it involved the examination of official witnesses for explanation and elucidation of points raised in audit. Obviously, the House as a whole could not undertake this responsibility and it was best remitted to a committee of the House. The Committee on Public Accounts thus came into being and soon emerged as the most powerful force in the control of public expenditure. The review of the audit report by the Committee completed the cycle of parliamentary control over appropriations granted.

But this was the main phase of control; there was yet another phase, the examination of the estimates presented to the House to ensure that they had been drawn up with due regard to efficiency and economy. The idea of entrusting this scrutiny to another committee of the House was actively canvassed. But it was recognized that such a pre-check would impinge on cabinet responsibility and would also commit the House to the acceptance of the estimates without a debate. These difficulties stood long in the way of constituting an Estimates Committee. Ultimately, the difficulties were met in an ingenious way, characteristic of the British, by excluding policy from the examination of the Committee and by providing for scrutiny of estimates after they had been passed by the House. The observations of the Committee were to be taken as guides for the preparation of estimates in succeeding years.

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The Government of India Act, 1935, which was the pathfinder for the transfer of responsibility had largely absorbed the financial principles and procedures of the UK outlined above, but there were also significant omissions. The concept of parliamentary supremacy enshrined in the Constitution having been borrowed from the UK, the Constituent Assembly made good these omissions on which this supremacy largely rested. The financial provisions of the Constitution bear thus a remarkable similarity to the financial provisions of the UK.

There is, however, an additional provision, a heritage of the 1935 Act, the provision of a public account. This account accommodates receipts other than revenues, such as deposits made by private parties, provident and other fund balances, premia on postal life insurance, postal savings bank balances, etc. These amounts are held in trust by government and repaid as and when required by the executive without authorization of the legislature. There is no such account in the UK. Funds of the nature mentioned are separately invested and are thus not available for public expenditure.

Though there is nothing inherently wrong in the retention of such an account, the way its balances are treated come in the way of applying parliamentary control over withdrawals from the Consolidated Fund. The balances of this account are not held separately and are merged in the cash balances of government. The result is that the balances of the account are frequently drawn upon without let or hindrance for meeting expenditure debitable to the Consolidated Fund. Often the balances held in the Consolidated Fund are not sufficient to meet the demands on it.

This has largely frustrated the purpose underlying Articles 114(3) and 204(3) regulating withdrawals from the Fund. In fact, under this system, nobody would know at any particular time, whether the Consolidated Fund has run dry or not. If moneys outside the Fund can be freely utilized for meeting expenditure legally payable only out of the Fund, the restrictions imposed by the passing of an Appropriation Act is rendered null and void in practice. All the fuss about preventing infractions of the Appropriation Act in this situation is meaningless. The prevalent practice is no doubt convenient and eases the ways and means position of government but it is not in accordance with the provisions of the Constitution. It is also contrary to the spirit and purpose of the Consolidated Fund. Whatever may be the financial embarrassment to government, it is imperative that the Public Account should be placed beyond the arbitrary reach of executive power.

An essential ingredient of a comprehensive financial control is Exchequer Control. In the UK, the Auditor-General is also the Comptroller-General of receipts and issues. In this capacity he fulfils an important role in the control of appropriations. Requisitions for withdrawals from the Consolidated Fund lodged in the Bank of England have to be countersigned by the Comptroller in token of his acceptance of the withdrawals as being in accordance with the vote of the House before they can be honoured. This may be regarded, in a sense, as the starting point of appropriation control.

The Constitution redesignated the Auditor-General as Comptroller and Auditor General. The change in designation envisaged a system of control over exchequer issues hitherto absent in the financial administration of India. But this function has yet to be developed. There are certain procedural difficulties which arise from the decentralized system of payments in force.

Exchequer control cannot be exercised unless there is a single source of funds and all payments are made centrally from this fund. Another drawback of decentralized payments made in hundreds of treasuries scattered all over the country is that it makes control of votes difficult, if not impossible. Though a scheme of control has been instituted and also an agency created to ensure that the controls are effectively applied,

its purpose has been largely frustrated by the retention of the outmoded accounting system. This system which has been in use well over a century has remained untouched by the significant changes in the concept and purpose of the state. As a result, accounting responsibility continues in the hands of an alien authority—the Comptroller and Auditor-General. This has not made it possible to devolve accounting and financial responsibility on the permanent secretaries as in the UK. Rationalization is, therefore, necessary on more than one consideration.

A limited experiment was tried by the last Auditor-General by transferring accounting responsibilities to two selected administrative departments in two states and also in one department at the Centre. The experiment in the states, however, failed largely as the departments had not been given larger financial powers which was a prerequisite of transfer of accounting control. Secondly, the controlling officers had neither any financial background nor had they been given any financial experience. The separation in the Centre, however, continued as the department concerned lent itself to the continuance of centralized payments but no extension of the scheme was made or is contemplated.

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Treasury control of expenditure is a necessary concomitant of parliamentary control but it is a continuous control applied both before and after parliamentary approval of estimates. The process of control is initiated when estimates embodying departmental plans and policies are submitted to the Treasury for examination and acceptance. This affords the Treasury not only an opportunity to assess them individually but also to have broad view of the policy of the departments as a whole. It is at this stage that treasury control over policy becomes operative and the role of the Chancellor as coordinator of financial and economic policies comes into play.

Till 1920, the Treasury exercised stringent expenditure control extending to itemized scrutiny of departmental expenditure. Gradually, there was the realization that this somewhat undefined duality of control was encouraging irresponsibility not only in the preparation of the estimates but also in the subsequent regulation of the flow of expenditure. It was also realized that it was unwise to dissociate policy from its financial consequences. It was with the advent of Warren Fisher to the Treasury as permanent Secretary that practical shape was given to what has now become fundamental principle of departmental responsibility—the responsibility for the preparation of the estimates with due regard to efficiency and economy and the subsequent responsibility for the beneficial and economic utilization of appropriations granted. The Treasury ceased thereafter to be "the singlehanded

champion of the solvency keeping ceaseless vigil on the buccaneering proclivities of the permanent heads of department".

As a result of this fundamental change in the concept of departmental responsibility the departmental estimates in UK are now subjected only to a broad examination in matters of principles rather than details. Once the estimates have been accepted by the Treasury and appropriations obtained, the departments are free to incur expenditure on their own. A reference back to the Treasury is only necessary if a new service is being initiated, the scope of a grant is being varied or the vote is likely to be exceeded. This liberalization has been made largely possible by two factors. First, the civil service in the UK is administered by the Treasury, which is thus in a position to make disposition of manpower with reference to both administrative and financial needs of government; secondly, a policy of periodical interchange of the senior officials between the Treasury and administrative departments has now been firmly established. As a result, the civil service is now a versatile cadre, which can take on either responsibility with equal facility. The permanent departmental secretaries are also separately named as Chief Accounting Officers by the Treasury with defined financial responsibilities, with abatement of direct Treasury control. The essence of this arrangement is that it ensures that policy and the consequences of policy go hand in hand.

Till recent years, the finance department in India was modelled on the Treasury as it was before 1920 with the 'saving of candle-ends' as its primary concern. Financial control was a two-stage control concentrated in the finance department; budgetary control and expenditure control. The finance department did not share its responsibility with any other department. In fact, it emerged as a specialized department with the claim that it was the sole repository of financial wisdom. This claim was strengthened further when in 1938, a special Finance-Commerce Cadre was constituted to fill all higher posts in the field of economic administration. In the absence of a scheme for installing personnel for financial scrutiny internally in the departments, itemized control extended even to the creation of minor posts in the departments. This pattern of control was adequate when the state had no defined social objectives and the bulk of expenditure related to administration with a pronounced emphasis on law and order and defence. But with the advent of Independence and the launching of Five Year Plans of economic and social development the unsuitability of the system came to be gradually realized. But there still is disinclination on the part of Finance Ministry to part with power fully and on the part of administrative ministries to assume responsibility.

The first significant step towards giving financial autonomy to the ministries was taken when the scheme of installing financial advisers

in the Supply Department, evolved during the War, was retained and gradually extended after Independence to other selected ministries. These advisers were, however, only outposts of the Finance Ministry and controlled by it. Financial scrutiny continued to be applied meticulously to details of expenditure and there was hardly any relaxation of the rigours of control. Even the technical details of development schemes and works programmes came to be questioned even though the Finance Ministry was not equipped for the purpose. As a result, the objections raised were often elementary and uninformed in character. This not only acted as an irritant but was also time-consuming. Ultimately, the objections were waived but after interminable discussions and avoidable delays. Control became effective only over establishment proposals, the expenditure on which was but an insignificant fraction of the cost. Whilst straining at the gnat, the Finance Ministry often swallowed the camel. Nevertheless, the location of financial advisers in the ministries and their close contact with the departmental officials gave each other a better appreciation of their respective problems.

Disturbed by the delay in the execution of projects and lapse of funds, Prime Minister himself felt that a relaxation of control should be made. The present writer was asked to undertake an examination, the result of which caused an explosion in the Finance Ministry, but unfortunately it left no scars. It was much later that a process of progressive delegation to the ministries was initiated.

The arrangements for budgeting and financial control in regard to civil expenditure were revised in August 1958. The essence of the new arrangement was that the major scrutiny of the Finance Ministry in respect of any proposed expenditure was exercised before the budget was framed. Subject to the observance of any general or special directions issued by government from time to time in regard to standards of expenditure, etc., and subject to the existence of budget provision, administrative ministries were free to issue sanctions to expenditure except that in regard to schemes which involved a total outlay exceeding Rs. 50 lakhs, the prior concurrence of the Finance Ministry was required. Where, however, the scope of a scheme previously accepted by the Ministry of Finance was substantially altered, even though the total cost was not exceeded or, if the total cost of an accepted project was likely to be exceeded, a reference to the Finance Ministry was necessary.

As a part of the revised arrangements, wider financial powers were delegated to the ministries. To assist them in exercising these powers they were provided with internal financial advisers with necessary supporting officers and staff. These officers were designated as Financial Adviser, Deputy Financial Adviser or Assistant Financial Adviser and

were given an appropriate *ex officio* Secretariat status in the ministry to which they were posted. These officers and staff, who formed the finance branches of the administrative ministries, were employed solely on financial, budgetary and connected work, and also assisted the administrative ministry in regard to the control of expenditure against appropriation. The officers were associated with the ministries concerned in the formulation of proposals for inclusion in the budget from their inception and consulted in all financial matters involving the exercise of enhanced powers now delegated and also in regard to matters requiring a reference to the Ministry of Finance. Where the advice tendered by the Financial Adviser of a ministry was not accepted by the Secretary of that ministry, the case was brought to the notice of the Minister-in-charge concerned and, in addition, a monthly statement giving a summary of the differences and the final decision taken was furnished to the Secretary, Ministry of Finance (Department of Expenditure) and to the Comptroller and Auditor-General.

Another step forward was taken in September 1961 when an experimental scheme involving delegation of additional financial powers to the Ministries of Commerce and Industry, Community Development and Cooperation and Information and Broadcasting and the Department of Food was introduced. The enhanced powers delegated related mainly to creation of posts, reappropriation of funds and expenditure sanctions to constituent units of approved projects.

The scheme retained pre-budget check but provided that this check would be applied at random. Budgets were required to be prepared in details so that post-budget references and checks could be eliminated. A work study group was established in each ministry which now had freedom to create posts on the basis of the studies made. It was also enjoined that powers should be delegated to the maximum extent possible to the subordinate organizations of the ministries.

Financial advice to these ministries continued to be rendered as in the past under the combined system of financial advice whereby the officers accredited to the department deal with both expenditure proposals falling within the delegated field and also those requiring the Finance Ministry's concurrence. The scheme which was sanctioned initially for a period of six months was extended for a further period up to middle of September 1962. It was also stated that government intended to extend the scheme to other ministries if this experiment succeeded.

The review envisaged was undertaken in early 1962 and the scheme was extended to other ministries and made a permanent feature of expenditure control in June 1962. The only exclusions were the ministries of Railways and Defence and the Department of Atomic Energy. But these ministries were differently organized and had a

fuller measure of financial autonomy even otherwise. The delegations made have undoubtedly moved into the watershed of decontrol but the goal of financial emancipation of the ministries has yet to be reached.

It is necessary, however, to sound a note of caution. A prerequisite of large scale transfer of financial powers to ministries is to equip them to exercise the powers with propriety and prudence. The induction of one or more finance officers, owing dual allegiance, does not fulfil this pre-condition. It is necessary now to introduce and enforce a well thought-out plan of interchange of officers between finance and administrative ministries so that there is a growth of financial responsibility at all levels in the secretariat. This alone will bring about efficiency and economy in which even the 'saving of candle-ends' would not be disregarded.

Though the delegations enjoined that there should be a redelegation of power to all executive levels commensurate with their responsibilities and status, there seems to be a singular disinclination on the part of ministries to part with power. It is imperative that delegations should be made contingent upon redelegation. Otherwise, the very basic purpose of delegation would be defeated. A feeling of frustration still persists at executive levels, discouraging the development of initiative and responsibility. This is hindering the expeditious and efficient execution of projects and programmes retarding the fulfilment of the plan of economic and social progress. This is an aspect of re-adjustment of financial authority which can no longer be lightly treated.

* * *

The economic disruption caused by World War II, its impact on the pattern of trade and commerce and the revolution it brought about in the way of life, accelerated the growth of collectivism which had germinated in the beginning of the twentieth century. The regulation of economic life became the more important function of government. This responsibility devolved primarily upon the financial wing of government.

It was realized that it was no longer sufficient to provide for balanced budgets and to exercise meticulous control over departmental expenditure; it was more important to provide for maintenance of full employment while avoiding inflation, achieving a satisfactory balance of payments and fulfilling major political and strategic objections which had economic implications. The economic situation and prospects of the country had to be continuously analyzed by a organized study and an assessment systematically made of world economic trends. The investment programme which was basic to the programme of capital development had similarly to be coordinated against which budget policy had to be determined. It was no longer enough when preparing

budget estimates to aim at producing cash surplus at the end of the financial year; it was more necessary to find satisfactory conclusions for the problems of inflation and deflation, for the investment programme and for the balance of payments and other allied matters.

This realization led to a major readjustment in the functions and organization of the Finance Ministry. A Department of Economic Affairs was constituted in 1947 which gradually grew in importance and elbowed out the Department of Expenditure from the place of pre-eminence it had hitherto occupied.

The Department of Economic Affairs is organized in six divisions of budget, internal finance, planning, external finance and foreign aid, economic intelligence and insurance. The Budget Division is responsible for the preparation and presentation to parliament of the budget of the Central Government other than railways. This is a coordinated effort involving the collection and consolidation of data relating to the receipts and expenditure of government from all revenue receiving and spending authorities. The estimates under the principal heads of revenue are prepared in consultation with the Department of Revenue and those relating to other heads on the basis of the data furnished by the ministries or their Accounts Officers. Similarly, expenditure estimates are adopted on the basis of the proposals received from the administrative ministries as approved by their Financial Advisers. The Plan allocations are made on the decisions taken in agreement with the administrative ministries and the Planning Commission. Likewise, the amount of the Plan assistance to the states is determined on the basis of the annual reviews in consultation with the state governments of the resources and requirements and after taking into account the overall financial position of the centre. The Budget Division is also responsible for estimating the capital receipts and receipts and expenditure under the various debt, deposit, revenue and remittance heads.

The Internal Finance Division deals with all matters connected with currency and coinage, Reserve Bank of India, State Bank of India, state associated banks, banking in general, administration of mints and assay offices, security printing, price control and capital issues, etc.

The Planning Division is concerned with the work connected with the preparation of capital budget and the allocation of ceilings on capital expenditure of the various ministries in consultation with the Planning Commission, the administrative ministries and the Department of Expenditure.

External Finance and Foreign Aid Division is responsible for economic and financial relations with foreign countries and international institutions. All proposals for fresh foreign exchange expenditure are scrutinized in this Division with a view to ensure that such expenditure is kept to the minimum consistent with the maintenance of economy

and execution of developmental programmes which have been accepted by government for implementation. Normally, six-monthly reviews are undertaken of the foreign exchange situation with reference to the availability of resources and the claims on them.

The Economic Division, which is mainly the department of the Economic Adviser, keeps under review the emerging trends in economy and advise the ministry on questions of economic policy. It undertakes tax research, studies internal and international economic developments and reviews public finance and planning.

Insurance Division deals with all matters connected with insurance and is particularly concerned with the administration of the nationalized Life Insurance Corporation.

While the Economic Affairs department is the natural home of the Budget Division, its inclusion in this Department has resulted in the separation of budgetary control from expenditure control. This seems inescapable in the present dispensation. When, however, the ministries are given full control over their financial affairs, a link should be provided with the Budget Division by installing high level officers who would perform advisory and inspection functions in its relations with the ministries.

The Department of Company Law which was at one time a wing of the Finance Ministry was transferred to the Ministry of Commerce and Industry but not on considerations of rationalization. This was a retrograde step as it disassociated capital issues and other allied matters from the administration of company law. It seems desirable that company law administration should be retransferred to the Finance Ministry, where it appropriately belongs.

Another important wing of the Finance Ministry is the Department of Revenue. Unlike the UK, where the Boards of Inland Revenue and of Customs and Excise are Statutory Boards outside the Treasury, the Central Board of Revenue in India administering both direct and indirect taxes has always been a limb of the Finance Ministry. The Board has however, statutory functions, distinct and separate from its role as a part of government. The Members of the Board have *ex officio* status in the Secretariat hierarchy and often sit in judgement on decisions given by themselves in their executive capacity. Not unnaturally, there is complaint from trade and industry that this irrational arrangement interferes with administration of justice in appeals preferred to government. The creation of an office of Secretary, Revenue, who is no longer a part of the Board, as before, has partially met the complaint. But it is by no means established that it is the best solution of this and allied questions of revenue administration. It has been urged by many that the Central Board should be no more than the Chief Revenue authority, concentrating on technical and administra-

tive functions. Taxation policy has to be based on economic considerations and the shares of revenue to be raised by direct and indirect taxes have also to be determined. It is the Economic Affairs Department which is in the best position to consider, in consultation with other economic ministries, the overall impact of particular imposts on trade and industry, in particular, and national economy in general. This issue has also been posed before government by more than one committee but a decision has yet to be taken.

The anomalies inherent in the administration of Customs, Income Tax and Central Excises arising from statutes enacted long ago influenced the Finance Minister to constitute high level committees on both direct and indirect taxes.

The Income Tax Act has recently been revised on the basis of the report of the direct taxes committee and the Sea Customs Act has also been remodelled. The Central Excise Committee has very recently submitted its report and a revision of the Excise Act will undoubtedly be taken up in due course.

There is evidence of increasing awareness in government of the need for reshaping its machinery to fulfil tasks which arise from the concept of a welfare state and the Five Year Plans of economic and social development. The piecemeal review undertaken in regard to financial administration has served only a limited purpose. It remains now to initiate a comprehensive high level review to give administration a new outlook and a new purpose and to make it flexible to respond to the changing needs of the present and the future. □

The Theory of Budgeting and Government Organization*

Arthur Smithies

BUDGETING, EVEN though it is generally, and perhaps properly, regarded as a dreary subject, is an important subject, because after all it does have a great deal to do with the policies that are finally adopted by a country. Sometimes people feel that finance is something that is beneath their contempt and feel that they want to devote their lives to policy-making rather than to finance. This, I do not think, is altogether a good distinction because the most ambitious policy-maker frequently finds his ambitions frustrated by obstinate and un-enlightened treasuries and ministries of finance. The moral of any story I have to tell you is this : policy-making and finance are essentially parts of the same decision-making operation and ought to be regarded as such. That observation would seem very trite if it was generally applied in practice. But as a matter of fact, it is not. Finance is usually regarded as the province of ministries of finance, and policy-making as the province of other departments. Also budgeting, as traditionally practised, is not very suitable for policy-making. It is conducted much more in the form that is possibly suitable for achieving honest administration. If anyone looks at the normal classifications of a budget for a single department, he will find that the categories that usually apply are the expenditure on salaries, travel, office furniture, and postage and telephones and things like that. This might have been a very suitable way to arrange a budget in a stable society that did the same thing year after year. You may be simply interested in keeping the departments running the same way you did last year. You may want to scrutinize the budget to see if they are hiring an extra secretary or buying an extra sofa or an automobile that they do not need. And the whole problem may involve simply eliminating waste from a budget by a careful review of these details. That is, as I say, the traditional way in which budgets are made. But it is a way that is increasingly in-appropriate under modern circumstances, where countries are concern-ed with untraditional rather than traditional matters, where they are embarking into new fields of government activity. In these circum-

*Text of a public lecture delivered at the Indian Institute of Public Administra-tion, New Delhi on December 11, 1962.

stances, budgeting procedures have to be radically changed. I am afraid I have not had much opportunity to examine the Indian budget. In some respects, I find it quite intelligible but it has still some of these characteristics I have been describing. It is one, as Prof. Menon told me, of the many legacies that one has inherited from the British, and on the other hand the Indian budget seems to be somewhat more intelligible than the British budget.

I find it useful to think of the activities of a modern government in terms of four main categories; it seems to me that modern government is concerned with defence, development, welfare, and with law and order. I think practically everything that a government does falls under one of those four headings, and of course it falls under innumerable sub-headings within each category. And one of the major problems of budgeting is to get the allocation of the resources available to government among these four things, and also to decide how much resources should be made available to the government in the total.

That sufficiently indicates that traditional methods of budgeting in terms of departments and organizations is not particularly suitable. What one is deciding whether enough money is being appropriated to defence and in order to decide that, you want to know something more than even the number of soldiers involved. You need to know not only the number of soldiers but also their equipment and ammunition and weapons. You have to have some conception of defence as an aggregate. You have to be able to form some kind of judgment of how much defence you get for the expenditure of a certain amount of money. Similarly, in the case of welfare, covering matters such as public health, education and so forth, you ought to have some quantitative ideas about what benefits in terms of end-results are derived from these operations. And again the ordinary classification of expenditure in terms of the employees of a public health department does not tell you anything about the extent to which cholera and malaria is being reduced in India. The point I am making is that you do need substantive information about how much malaria control you get from the expenditure of certain number of dollars. Similarly, under the category of law and order, the number of policemen does not tell you how much less law and order there is. You would like to know the number of traffic violations and undetected crimes. You would want to know something of the results of efforts to maintain law and order. This is what is meant by programme budgeting: how much benefit in a meaningful sense, you get from expenditure.

I do not suggest that you can measure defence in terms of physical units of defence, or health in terms of physical units of health. It is a good deal more difficult than that. On the basis of a great deal of empirical information, people concerned with the budgets do have to

make a qualitative judgment: how effective expenditures on defence are. In the United States, particularly in connection with the defence programme, a new word has come into the vocabulary and that is 'cost effectiveness'. It means you examine expenditure in a certain direction and decide in a qualitative way how much defence you can get for them. You go further than that. You examine expenditure in a particular area. You examine the various alternative ways, say, of spending one lakh of rupees, and you decide on the best way of spending a lakh of rupees on public health, which means that you try to get the maximum 'cost effectiveness' you can from the expenditure of a lakh of rupees. It is this kind of procedure that one calls programme budgeting, and you can see from these few examples that there is a vast distinction between both the methods and formulation of a programme budget, and the formulation of a traditional budget in terms of numbers of civil servants, numbers of secretaries, typewriters and automobiles, which do not really tell you much about malaria control.

* * *

Let me now try to indicate how I think budgeting fits into the decision-making process as a whole. For my purpose I divide decision-making by governments, also by universities, institutes and other organizations into a number of categories that I find useful.

The first category is policy-formation or perhaps better formation of policy objectives. In a very general sense, no organization can operate unless it has some idea what it wants to do. If you set up a university, it does have some hopes and dreams about what it wants to accomplish. These hopes and dreams are the results of the thoughts and ambitions of imaginative people at the head of it. But these are the people who have little track with the budgeteers, and these are the very same people who keep the organization alive and a success.

Policy objectives, however, may be formulated in very vague terms. Supposing you try to set out the objectives of India as a country. Or suppose you take a smaller question, the objectives of the university. We are connected in some way or another with the university. Can one articulate in any precise way the objectives that a university is trying to achieve? I think it is rather difficult to do that. Formulation of policy objectives involves acts of the imagination—and fairly imprecise acts of the imagination I feel sure that the leaders of a country are not particularly clear about what their goals ultimately are except in a very general sense. But, of course, before action is taken, things must become a good deal more concrete.

And that brings me to the next stage, what I call the decision-making process, which I call planning and then programming. I think these two words, planning and programming, cover what

is meant by planning in India. But I want to use it in two words, and I take the word planning in this connection more from what the military people do. Let us suppose that our policy objectives relate again to defence, development, welfare and law and order. You can think of a country having very different plans with respect to those four things. You can think of a country emphasizing its economic development and subordinating all other objectives. You can think of a country putting its military strength ahead of all its other objectives. You can think of a country putting law and order ahead of most of its other objectives, or you can think of a country concentrating on an immediate welfare state. You might find these various differences in emphasis in not too lengthy history of your own country.

Plans change and one can think about a constellation of different plans, and it is the business of a level of decision-makers to try to articulate various plans with not too much restraint of narrow considerations of feasibility. But I emphasize the need for a selection of plans out of which to choose. You do not have much room for judgment if you just have one plan instead of four. To illustrate, I was very interested to see a few weeks ago an Indian document which contained a perspective up to 1975. In order to form some kind of judgment, you should be able to say what are the alternatives. But what might the country have done and what are the available alternatives. It seems to me that the process of rational judgment about a course of action essentially involves a consideration of available alternatives.

The next stage I call the programming stage, which is more like what you call planning here. This involves something like a Five Year Plan, involving not only economic development but involving other considerations. It is going to involve defence and also law and order. Programming is the adoption of a five year programme among the available plans as a guide for more short-run operations.

Finally, we come to the budget, which is the fourth stage of these operations, and which involves further refinement of the programme, involving more precision and more careful calculation and a more specific commitment by the government. The budget is the actual plan of action for the government during the forthcoming year. At the budgeting stage, one does become more specific about the objectives involved in the programme and one is particularly concerned with this question of cost effectiveness of which I was talking about, in ensuring that the money spent in various directions will be to the maximum benefit.

Both the programming and the budgeting stages involve the adoption of a single unified programme or plan of action which involves again questions of comparison and alternatives. Those of you who are economists will recognize in my expcsiting moie or less a transla-

tion of the simple economic choices of the categories of public administration. In selecting a programme among the available array of alternatives, one has to consider the relative merits of the things like defence and development. This is the hard kind of choice which will face your country in the near future. One has to consider the relative merits of development and welfare, and the relative merits of law and order, and one of the other things. How have these choices to be made? May be they do have to be made in very concrete terms. The decision-makers of your country will have to decide, within the framework of the resources available to it, how much of the other objectives have to be sacrificed in the interest of national defence. National defence is going up. Unless the total resources can be enlarged, the increase in defence must be at the expense of perhaps some aspects of the development, perhaps, in some aspects of national welfare, or I hope not, at the expense of law and order. To give that up may destroy all one's hopes. Probably the broad choices are: what frills you take off—welfare and development—for the sake of national defence, unless you can enlarge the total. This involves a question of choice at the highest political level. This kind of choice cannot be made or should not be made by officials down below. It is a responsibility of Prime Ministers and Cabinets.

Suppose the choice boils down to this. You want two or three more army divisions, and to provide the resources for two or three more army divisions might mean settling the aggregate rate of growth of 5 per cent rather than $5\frac{1}{2}$ per cent. This is a very high political decision that has to be made. I feel reasonably persuaded that the decision can best be made if the Prime Minister and the Cabinet have full information about the consequences of cutting the budget for development and increasing it for defence, if they know what the cost effectiveness is. This is the way, I think, a budget has to be worked out if it is to be rationally conceived budget as it is better than an irrationally conceived budget.

Suppose you did not do this. You did not have a conscious way of weighing alternatives against each other. Suppose you said defence has absolute priority. We must have 10 or 15 divisions here. We will do that and everything else will take a chance. Or suppose you said, let immediate social welfare have priority over everything else. In either case you will starve the country of resources for development to such an extent that you could not afford the social welfare or defence on the same scale some years from now. One can easily satisfy oneself that hit or miss methods in this area are inferior to rational methods involving comparisons of alternatives.

Furthermore, the resources available to the government are not necessarily fixed, and that is the second part of the budgeting. How

big a budget the country is prepared to finance? How much is the country prepared to finance either by paying taxes or by borrowing money at home or abroad? In other words, is the total benefit of the budget worth the cost that it imposes on the Indian economy? And that is the second matter for high political decision. Is the country going to benefit from this budget to such an extent that it is worth the taxes? Or the question may be asked in more specific political terms : will the political party in power get elected at the next election if they impose a given tax burden on the public? Will the public be sufficiently sensitive to the benefits that are conferring on them by the budget? That again is a matter for the highest political decision. But it is also a matter for effective and complete information. This is a tremendously difficult matter to distil this vast complex of information in such a way that the man at the top, the Prime Minister, for instance, can absorb it. He, after all, is not all-wise, and not omniscient. He has not an infinite mind. He has a fine human mind and to put the affairs of the country, however distilled, into one head, is a task requiring very first-rate staff work.

So I have attempted to indicate what I meant by the budgetary process. I hope I have indicated in the course of this discussion what I mean by programme budgeting as distinct from traditional budgeting.

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Let me conclude by saying just a few words about the question of administration and the implications of these remarks for administration. I have stressed several times the need for top-level decisions in this area. I have mentioned several times the Prime Minister of a country rather than the Finance Minister because it seems to me that the budget, since it is a crystallization of policy for the country, is not a thing that should be delegated to the second in command. We have been through all this in the United States, and after a long period of trial and error and experimentation, it has, for the last twenty years or so, been established that the President, and no one short of the President, is responsible for the budget. The Budget Director in the United States is probably the man who sees the President more than anyone else does; and I know from my own experience in the administration that the President does become very fully informed of the content of major budget programmes, and does make some of these choices that I have been talking about. I am not suggesting that American procedure in this respect is by any means perfect, but a good deal of progress has been made. But the problem is so vastly complicated that much more progress needs to be made.

So I do want to stress, first, top-level responsibility and secondly, top-level simultaneous consideration of the components of the budget.

It seems to me it is necessary for the Prime Minister and the Cabinet to think about the budget as a whole to make these comparisons between development and defence and to make the comparisons between the benefits from expenditure and the burden from taxation. I am not very clear about how it works in India. It is not done very explicitly in the English system, if at all. Actually the cabinet considers quite briefly one department's estimates after another. It does not have all of them before it at the same time. And after it has dealt with expenditure, it then deals with taxation, and does not make the comparisons I am talking about. Furthermore, a great many of the decisions are made by the bureaucrats in the Ministry of Finance rather than brought up and crystallized by the top-level to make the decision.

Although Treasuries do give a certain amount of stability to a country's affairs, I have greater faith in the political wisdom of the elected leaders of the country as a rule than the wisdom even of the most skilful bureaucrats from this point of view. So I stress it in the matter of top-level decisions.

I also stress the need for effective staff work—on two sides. I mean staff work in terms of knowledge of the various programmes and policy terms. The organization need effective staff work in terms of cost effectiveness of finding out cheaper ways of doing specific things and also getting more benefit from expenditure of given amounts of money.

I conceive of the central budget organization as a kind of mediator and arbitrator among the various executive departments. I think of the executive departments as the claimants on the budget, and in order to make their claims satisfactorily, they have to have satisfactory budget organizations of their own. The Treasury, in one of its aspects, or the Ministry of Finance—those are the custodians of the public purse, are the claimants on behalf of the taxpayer.

The central organization that prepares the budget assists and advises the Prime Minister or the President, in weighing these conflicting claims of the departments on the one hand, and the Treasury on the other, in such a way that you can achieve this simultaneous consideration of all aspects of the budget. The final steps are collective approval by the Cabinet and then by Parliament.

This is roughly my conception of an effective national budget administration. □

Performance Budgeting in India—A Review of the Developments, Present Status and Prospects

S.S. Viswanathan

THE BUDGETARY system in India, as in many other countries, has been designed and developed mainly to facilitate financial and legal accountability of the executive to the legislature, and within the executive, observance of similar accountability on the part of each subordinate agency. The main objective is to ensure that funds are raised and money is spent by the executive in accordance with and within the limits of legislative sanctions and authorizations. Accordingly, the budgets emphasize the financial aspects and do not inter-relate financial outlays with physical targets and achievements. During the past two decades, it was becoming increasingly clear that in the context of a planned economy and the growing size and complexity of governmental activities, there is a need to reorient our budgetary system to the new developmental responsibilities of management in ensuring fulfilment of Plan objectives. It was felt that the budget should help reveal what was proposed to be done in terms of the programmes and activities of government and how effectively and economically they are realized. In other words, the budget should give a comprehensive picture of the total efforts of government in its functional fields, the economics of the programmes and activities, the results that flow from them and the relationship between inputs and outputs.

IMPORTANT DEVELOPMENTS

It was in the wake of such an awareness that there were occasional demands in India too for performance budgeting—a table given, first of all, by the Hoover Commission[1] of the USA in 1949.

In the Lok Sabha, a mention about performance budgeting was made for the first time in 1954 during the debates on the Finance Ministry's control over expenditure. An important development

[1]The Commission on the organization of the Executive Branch of the Government, Chairman: Herbert Hoover, *Budgeting and Accounting*, Washington, 1949.

took place later when the Estimates Committee of the Second Lok Sabha in its 20th Report[2] recommended that "performance budgeting should be the goal which should be reached gradually and by progressive stages . . .". While noting the suggestions of the Committee, the government indicated[3] that the matter was under examination and that the feasibility of the use of the technique would depend on the outcome of the examination. The Committee had also recommended (paras 25-26 of their Report) that industrial undertakings should prepare performance-cum-programme statements as also business type budgets. These suggestions were reiterated in the Committee's 60th Report.[4] The need for the preparation of performance-cum-programme statements by industrial undertakings was stressed again by the Committee in its 73rd Report[5] on Public sector undertakings. To this, the government responded by issuing a circular, in June 1961, drawing the attention of the Union ministries to the recommendations of the Committee and asking them to consider the issue of suitable instructions to the public enterprises. But there was no progress. However, continuing efforts were and are being made by the government in increasing the usefulness of the conventional budgets. Consequently, more data is now available in the Union and State Budgets. For example, the Explanatory Memorandum (parts I and II), Economic and Functional Classification, Notes on Important Projects and Schemes, Plan-Budget link, etc., presented by the Union Government now give valuable additional information.

Though more information is now available in the various budget documents, they do not fully serve to meet the needs of the present day situation. The object-cum-organization classification of expenditures in the budget does not enable identification of programmes and projects. It is not related to the cost-output aspects. The various documents do not also provide information on what government is doing, how much it is doing, at what cost, and with what results. Though it may be possible to cull out such information from files and various reports, it cannot be directly linked with financial data appearing

[2]Twentieth Report of the Estimates Committee, 1957-58 (Second Lok Sabha) on *Budgetary Reforms*, New Delhi, Lok Sabha Secretariat, 1959, paras 21-22, p. 12.

[3]Ministry of Finance Department of Economic Affairs, Government of India, O.M. No. 10 (35)B/58, dated 10-9-58.

[4]Sixtieth Report of the Estimates Committee, 1958-59 (Second Lok Sabha) on *Budgetary Reforms*, New Delhi, Lok Sabha Secretariat, 1959, Chapter IV, Items 11, 13 and 14, pp. 34, 35 and 37.

[5]Seventy-third Report of the Estimates Committee, 1959-60 (Second Lok Sabha) on *Preparation of Budget Estimates of Public Undertakings and Presentation of their Annual Reports and Accounts to Parliament*, New Delhi, Lok Sabha Secretariat, 1960, Chapter II, Paras 3 and 4, pp. 3 and 4.

in the budget. Performance budgeting seeks to remedy the defects by highlighting management considerations. It seeks to bring out the economic, financial and physical aspects of each programme and activity. The emphasis in performance budgeting is on the accomplishments rather than on the means of accomplishment, on the precise definition of work to be done or services to be rendered rather than on the money spent on several items. According to the Hoover Commission, "the all important thing in budgeting is the work or the service to be accomplished and what that work or service will cost". Performance budget, in essence, is a financial and work plan in terms of functions, programmes, activities and projects with their financial and physical aspects closely inter-woven in one document. This helps in the establishment of a meaningful relationship between inputs and outputs or costs and results.[6]

INTRODUCTION OF PERFORMANCE BUDGETING

In early 1965, a small unit in the Committee on Plan Projects (COPP), Planning Commission, undertook pioneering case studies with a view to considering the adaptability of the technique of performance budgeting under conditions obtaining in India. These efforts proved useful and the members of the unit were later taken as members of the Working Group on Performance Budgeting, set up by the Study Team on Financial Administration of the Administrative Reforms Commission. Based on the Report of its Working Group and the Study Team on the subject, the Administrative Reforms Commission (ARC) recommended the introduction of performance budgeting. *The ARC Report on Finance, Accounts and Audit*[7] containing this major recommendation was an important event in the budgetary history of India.

It may be mentioned in this connection that the Working Group had suggested the introduction of the new technique in two or three developmental departments, to start with, and to consider its extension to other departments gradually in the light of experience gained. Thus, while the Working Group appreciated the need for performance budgeting and its early introduction, it had favoured a policy of gradual change, for obvious reasons. The Study Team had also endorsed

[6]For a detailed discussion on the subject, please see Report of the Working Group on Performance Budgeting contained as 'Accompaniment B' in the *Report of the Administrative Reforms Commission's Study Team on Financial Administration*, New Delhi, Manager of Publications, Government of India, 1967.

[7]Administrative Reforms Commission on *Finance, Accounts and Audit*, New Delhi, Manager of Publications, Government of India, 1968. See also Annexure added to this article, p. 28.

this approach. But the Commission went further and recommended that, starting with 1969-70 and ending with 1970-71 budget, performance budgets should be prepared for all developmental departments at the Centre and in the States. Dictated by practical considerations, the Government of India decided against any rigid time schedule, but agreed that performance budgets should be prepared in all developmental departments in a gradual manner.

It will be relevant, at this stage, to take stock of what the ARC had recommended, in what manner the recommendations were accepted, what action was initiated by the government, and what remains to be done. The Annexure showing the recommendations of the ARC on performance budgeting, accounting and other related matters and the decisions of the Government of India, is given at p. 28. The statement may give an impression that the needful has either been done or is being done and that it is only a matter of couple of years before performance budgeting is introduced all over the country. From what is discussed below, one could see how far away we are from the goal and how much still needs to be done.

Only a Beginning

Even before the Government of India accepted the ARC's recommendations, a document styled as "Performance Budgets of Selected Organizations 1968-69" covering four Union ministries/departments (16 organizations and services in all) was prepared by the Ministry of Finance and presented to parliament in April, 1968, a few weeks after the presentation of the annual budget. This was indeed laudable. The scheme was extended to five more ministries/departments in 1969-70, and two more (seven organizations) were covered in 1970-71. Apart from the inadequacies of data regarding targets, norms and other relevant performance indicators which are inherent in first attempts of this kind, and of which the government themselves are aware, the question is whether we can say that in the departments and organizations covered so far, performance budgeting has been really introduced. The answer is a definite no. We have only partially succeeded in converting the existing Demands for Grants into the format of a performance budget with whatever data that could be had. This does not amount to installing the technique in any sense of the term. Of course insofar as this helped in familiarizing the technique to a large number of persons both within and outside the concerned departments, it is a welcome and necessary first step. But what about further follow-up action? To what extent have the departments, whose performance budgets have been prepared, taken steps to improve them, make use of them for control, and initiate necessary measures for streamlining their financial and work procedures,

evolving suitable work units and work-measurement techniques, or installation of a management oriented information system? It is here that we find the position not very encouraging.

FOLLOW-UP MEASURES

The Central Unit in the Ministry of Finance (Budget Division) which has the overall responsibility in this regard, had issued instructions and guidelines[8] to the ministries, etc., for follow-up measures. Working Groups were required to be constituted in each ministry to consider preparation and development of appropriate performance budgets, to arrange for the collection of needed data, to evolve suitable norms for performance appraisal, etc. Most of the ministries have actually constituted such groups and they even had some deliberations. Welcome as these developments are, one cannot rest on one's oars until the whole department of organization right from the lowest field units is guided and equipped for the employment of this technique. Performance budget has to be built up from below and not imposed from above. This calls for massive efforts in training and orienting the various top, middle and lower level officials and improving the administrative and financial systems.

Need for Training

The ARC has recommended and the government have accepted the need for a suitable training programme. So far, for the senior and middle level officers of the Union and State Governments, including public sector undertakings, the training or orientation in performance budgeting is being given at the Indian Institute of Public Administration (IIPA). For the Section Officers and Assistants of the Central ministries/organizations, such training is being given by the Secretariat Training School of the Home Ministry. Eight courses on performance budgeting and five courses on budgeting and financial control (covering performance budgeting) have so far been conducted by the IIPA covering about 380 officers. The seven courses organized by the Secretariat Training School catered to the needs of about 200 government employees. Besides, one special course on performance budgeting for top financial management personnel of public sector undertakings was also organized in February, 1970, by the IIPA. The coverage of training requires to be extended to many more officers and other employees at the Union and the state levels, including those in the public sector. Particularly, much remains to be done

[8]Ministry of Finance, Department of Economic Affairs, Government of India, O.M. No. FI (11)-B/68, dated 21-3-69, and O.M. No. FI (3)-PBU/69, dated 28-10-69.

to orient the top executives, such as Secretaries, Joint Secretaries and heads of departments. Unless they are convinced of its utility, not much headway could be made towards the introduction of performance budgeting. The task is indeed stupendous. Efforts need to be intensified.

DEVELOPMENT AND INSTALLATION OF THE SYSTEM

Training of Trainers

Apart from the need for a continuing training programme on a larger and more comprehensive scale by institutions like the IIPA and the Secretariat Training School of Delhi, training courses in performance budgeting at the various training institutions in the country, run by the state governments or otherwise, have also to be arranged to cover more persons in the states and local bodies. For this, a nucleus of trained persons should be developed at these centres as early as possible. Also, those who have already been oriented to this technique should share their experience and knowledge with others in their respective departments/organizations.

Active State Governments

Already, some of the state governments and their training institutions have taken initiative in the matter. Special training courses were organized for the Andaman and Nicobar Islands Administration, and Nagaland and Rajasthan Governments by the IIPA. The faculty for some of these courses included an officer of the Union Finance Ministry concerned with performance budgeting. More states are thinking of similar courses. Some had brief orientation courses or special talks which, to some extent, helped in explaining the technique. A few states have also decided to make a modest beginning by introducing the new technique in a few departments. Punjab was the first state to present early in March, 1970, performance budgets for three of their departments for the year 1970-71. Tamil Nadu has also presented performance budgets of two departments for 1970-71. Uttar Pradesh is another state which has prepared performance budgets for three departments for 1970-71. Maharashtra is yet another state which has come out with performance budget for one department. These performance budgets are more or less on the pattern set by the Government of India and suffer from various deficiencies. With more states expected to follow, it is necessary to chalk out a planned training programme to cover the states effectively.

To supplement the efforts of the Ministry of Finance in the field of performance budgeting, a Study Group has been set up in the Financial Management Unit of the IIPA for helping the Union and

state governments and public-sector undertakings in the installation of performance budgeting. Government of India has fully supported this move. The Unit would consist of about 10 senior officers with the required skill and experience in areas of government accounting and budgeting, public finance, economics, modern management techniques, such as PERT/CPM, cost accounting and so on. These officers are being drawn from the Union and state governments as well as from universities/research institutions. The idea is to have an inter-disciplinary team approach.

A Depth Study of the Central Public Works Department

The primary task of the Study Group in the IIPA is to take up select Union ministries/departments and later department in the states for intensive studies of the organizations concerned and to guide their officers in the installation of the new technique in an effective manner. Some public sector undertakings are also to be taken up in due course. To begin with, the Central Public Works Department (CPWD) has been taken up for a depth study of the administrative and financial management systems and procedures in vogue, delegation of powers and other related aspects with a view to considering their improvement or adaptation for performance budgeting. Since such a study has to be comprehensive and as performance budgets have to start from the roots, the lowest executive unit, *i.e.*, a division in the CPWD, has been taken up and four representative divisions in Delhi are proposed to be covered. Work in this regard is in progress. The idea is to bring out model performance budgets, with the help of concerned officers of the divisions to be studied, for the guidance of the other divisions in the department. With necessary guidance, training, seminars and discussions it is hoped that the department will, in due course, be in a position to build up the necessary structure for performance budgeting and develop the necessary norms and cost-output data. A practical manual on performance budgeting for the department is also to be drawn up after the studies in one circle are completed and the results discussed. A similar study is also proposed to be started soon in respect of some projects of the Ministry of Irrigation and Power.

The main emphasis in the task taken up by the Study Group is to help the organizations in developing and installing an adequate performance budgeting system. Training and orientation courses are incidental to this important work of installation which needs to be stepped up.

A reference was made earlier to the setting up of working groups in the Union ministries/departments to prepare and pursue performance budgets. A number of departments have prepared performance

budgets, though with inadequacies. They have to be actively helped in improving the quality of the documents, adjusting the financial management systems and evolving suitable workload factors, norms and standards. The Central Unit in the Budget Division of the Ministry of Finance has been doing this job. Some of the ministries have not shown any keenness to appreciate the utility of the technique and to make improvements in the performance budgets prepared. This is largely due to the lack of understanding, support and the necessary motivation at various levels. Vigorous and urgent efforts are needed to convince them of the advantages of performance budgeting as a valuable aid in management.

PROSPECTS

The Government of India have committed themselves to performance budgeting. It is, therefore, very necessary that adequate top-level support is provided in full measure. Without the active backing from the top, the results are bound to be disappointing. Parliament has been informed of the government's acceptance of the recommendations of the ARC on performance budgeting and allied issues. The movement will get a fillip, if parliament and its committees evince keen interest in the implementation of the relevant recommendations. Perhaps, a seminar for a day or two for the benefit of interested parliamentarians and particularly the members of the Estimates Committee may help the cause of peformance budgeting a good deal.

Some of the recommendations of the ARC on accounting and connected matters that have vital bearing on the success of performance budgeting, have been referred to a Team of Officers. The Annexure (p. 28) indicates the items referred to the Team. One of their important tasks is to streamline the accounting heads to suit the needs of performance budgeting. The Team has made some progress and it has recently circulated some proposals on accounting reforms for the comments of Union ministries and state governments. The work involved is complex in nature. Unless it is completed early and rational heads of account evolved, performance budgeting cannot be sustained. The important question of adequately equipping the accounts and finance cells of the departments and organizations also remains to be properly solved.

The role of initiator, coordinator and trainer—rightly given to the Ministry of Finance—calls for a strong enough cell there to discharge these functions effectively. At present, the Central Unit in the ministry has only one Deputy Secretary and one Research Officer. This seems to be hardly adequate for the job involved in coordinating the efforts of various organizations. Though in the last couple of

years, the Unit has helped the ministries in preparing performance budgets, it could contribute more, if it is adequately staffed.

It is gratifying to note that considerable interest has been shown by state governments in the technique of performance budgeting. The interest needs to be stabilised and the utility of the technique demonstrated. The introduction of such a technique involving some fundamental changes in the procedures and systems has necessarily to be on a gradual basis, but there should be clear evidence of a determined and planned approach to reach the goal. The Ministry of Finance has to play a more positive role in the installation process both at the Union level and in the states. Greater emphasis should be laid on improving the quality of the performance budgets prepared rather than on additions to the list. It would be even desirable to halt the process of mechanical conversion of the existing budgets which does not serve much purpose. Intensive efforts are needed to make the performance budgets—already prepared—meaningful, useful and operational documents. For this, much needs to be done to improve the financial management practices prevailing now. In particular, the departments need to be helped in developing a proper reporting system. Priority should be given to the preparation of performance budgets for capital projects with supporting planning and scheduling network (PERT/CPM). In the area of public-sector projects, there is urgent need for proper planning, programming, budgeting, reporting and appraisal to ensure their timely, efficient and economical implementation. Therefore, training for public-sector personnel should be conducted in a big way and the enterprises helped to develop appropriate performance budgets as early as possible.

Annexure

STATEMENT SHOWING THE RECOMMENDATIONS OF THE ADMINISTRATIVE REFORMS COMMISSION ON PERFORMANCE BUDGETING, ACCOUNTING AND ALLIED MATTERS AND THE DECISIONS OF THE GOVERNMENT OF INDIA

CHAPTER II—THE BUDGET

Recommendations

1. (1) The departments and organizations which are in direct charge of development programme should introduce Performance Budgeting. This should be done both at the Centre and in the states.

(2) The performance budget documents should be prepared in the following manner. A programme and activity classification should be made for each department or organization selected for the purpose of performance budgeting. Besides presenting the financial needs of these programmes and activities, the expenditure should be classified in terms of 'Object', *e.g.*, 'Establishment'. This should be followed by a narrative explanation justifying the financial requirements under each activity. This explanation should include information on targets, achievements, relevant workload factors, comparative performance over the years, etc. All this will constitute the performance budget. It should be accompanied by the Demands for Grants which will continue to serve as the medium through which appropriation control is exercised.

Action Taken

Government accept these recommendations. Performance budgets in respect of four ministries and some organizations under them for the year 1968-69, in the manner recommended, were prepared and presented to parliament in April, 1968. It is proposed to extend the scheme to as many organizations and ministries as possible for the year 1969-70.

Recommendation

1. (3) The programme and activity classification referred to in (2) should be entrusted to a team consisting of officers drawn from the Ministry of Finance, the administrative ministry concerned and an officer of the Audit Department.

Action Taken

Government accept the recommendation subject to the modification that an officer of the Audit Department need not be associated with the team, but where necessary the Audit Department will be consulted in evolving the programme/activity classification.

Recommendation

1. (4) In the departments and organizations where performance budgeting is to be introduced, the administrative and financial management system covering the planning, programming, budgeting, reporting and evaluation should be strengthened with a view to adapting these to the requirements of performance budgeting.

Action Taken

Government accept this recommendation and the implementation has begun under the revised system of financial control.

Recommendation

1. (5) A suitable training scheme should be devised for those who, at different levels, will be concerned with the introduction of performance budgeting. The Finance Ministry should prepare a manual on performance budgeting covering the various issues involved and containing instructions of a practical nature for the guidance of all concerned with the budgetary process.

Action Taken

Government accept this recommendation and have already started implementing it.

Recommendation

1. (6) The report of the Working Group on Performance budgeting may be taken as illustrating the lines on which a performance budget is to be prepared.

Action Taken

Government accept the recommendation.

Recommendations

1. (7) In as many as possible of the departments and organizations selected for performance budgeting, the scheme should be

introduced with effect from the budget for 1969-70. For the others, the scheme may be introduced in the Budget for 1970-71.

(8) The Finance Ministry should assume responsibility for introducing the system, and give a lead to the states in the matter.

Action Taken

In view of the problems involved in the introduction of this technique, government consider that the scheme will have to be introduced in a gradual manner

As regards preparation of performance budgets at the state level, it is primarily a matter for the state governments to consider, but any assistance the states may require will be made available to them in this regard.

A copy of the performance budget document already prepared has been forwarded to the state governments who are also being addressed in this matter.

Recommendations

2. (1) The structure of major heads of accounts may be reviewed and recast in terms of broad functions and major programmes of Government. The heads of Development adopted for Plan purposes may also be reviewed with a view to establishing a direct correlation between these heads and the general accounting heads.

(2) Programmes, activities and projects of all the departments and organizations where performance budgeting is sought to be introduced should be clearly identified and the minor heads connected with these programmes suitably recast so as to reflect these activities.

(3) Representatives of the Comptroller & Auditor General, the Planning Commission, the Finance Ministry and the administrative ministry concerned should be associated with the task of drawing up a programme for the implementation of recommendations (1) and (2).

Action Taken

A Team of officers consisting of the Deputy Comptroller & Auditor General, the Joint Secretary (Budget) of the Finance Ministry and a representative of the Planning Commission is being set up to undertake a review of the Heads of Accounts and the Heads of Development adopted for Plan purposes. An officer of comparable level of the concerned

Administrative Ministry will be co-opted wherever necessary.

Recommendation

2. (4) Statements should be prepared each year, as a supplement to budget documents, analysing the Plan Outlays under various heads of development into components corresponding to the accounting heads.

Action Taken

Government accept the recommendation. The Plan Schedule in respect of each Demand for Grants presented to parliament is being amplified in order to show the Heads of Development linking them with the Heads of Accounts.

Recommendations

12. (1) The Finance and Accounts Branches of the administrative Ministries should be suitably strengthened wherever necessary and staffed with qualified and well-trained personnel.

(2) The Finance Ministry should help the administrative Ministries to organize well-equipped internal Finance Branches. For this purpose, it will be necessary to : (*i*) ensure proper training of the junior officers, (*ii*) to provide suitable opportunities for officers in the middle levels to acquire varied experience and knowledge of public administration.

Action Taken

Government accept these recommendations. The orders already issued by government regarding financial control provide for the strengthening of the Finance and Accounts branches of the ministries.

Recommendation

16. The Budget Estimates included in the Demands for Grants and the corresponding central accounts compiled in the various accounts offices should be made more compact and comprehensible by the following measure:

(*a*) The details containing break-down of primary units of appropriation into detailed heads may be eliminated from the central accounts compiled in the various accounts offices and to the extent considered necessary for administrative purposes be recorded only in the department accounts.

(*b*) The entire structure of primary units of appropriation may be reviewed by the Ministry of Finance in the light of the wider powers of reappropriation now available to the administrative ministries and consistent with the objective of simplifying the accounting structure.

(*c*) The structure for the Demands for Grants may be simplified by a grouping of individual schemes within a homogeneous programme to the extent feasible and the detailed break-down for smaller schemes involving an expenditure of say, less than Rs. 5 lakhs may not be provided in the budget papers.

Action Taken

This recommendation is closely allied to recommendation No. 2 relating to the revision of the Heads of Accounts and the Heads of Development and will be entrusted to the Team of Officers being set up to review the Heads of Accounts.

Recommendations

18. (1) The Internal Financial Adviser with proper assistance at subordinate levels should be charged with the responsibility for establishing and maintaining an efficient accounting set-up within the administrative agency. The accounting set-up should be such as to ensure the timely submission of accounting data and analysis to the executive authorities to assist their managerial performance and should include an efficient organization for internal audit as well as the employment of modern techniques, such as cost accounting and management accounting.

(2) Adequate arrangements should be made for imparting suitable training to the accounting personnel at various levels.

Action Taken

Government accept these recommendations. It is proposed to refer the practical aspects of these recommendations to the Team of Officers referred to earlier. □

Budget Management Techniques: A Perspective for India*

K.L. Handa

THE BUDGET has been, historically, evolved as a document which records anticipated receipts and payments for a given period of time. Its use as an instrument for ensuring accountability of the executive to the legislature under a democratic form of government has also been a heritage of the past.

The exercise of legislative and executive controls through the budget meant enforcing the limitations and conditions set by the appropriations, ensuring legality and regularity of expenditure, and requiring observance of the necessary sanctions, rules and regulations by the spending authorities. This evolution of the control oriented budgetary system was followed by developments, in recent decades, to use budget as a tool of management for an efficient and economical use of resources for the implementation of government programmes and activities. A further addition to these budgetary concepts has recently been in treating budget as an instrument for planning an effective use of funds for achieving the objectives of the government.

The budget is also used as an instrument of economic and social policies to express and implement the preferences and priorities of government. The need for a budget has, thus, been accepted to serve a variety of purposes. A budget can be many things depending upon the manner of its structuring and the uses to which it is put. According to Wildavsky, a budget may serve diverse purposes and can be

> a political act, a plan of work, a prediction, a source of enlightenment, a means of obfuscation, a mechanism of control, an escape from restrictions, a means to action, a brake on progress, even a prayer that the powers that be will deal gently with the best aspirations of fallible men[1].

A number of budgeting techniques have been evolved to achieve

*From *Indian Journal of Public Administration*, Vol. XXVI, No. 3, 1980, pp. 648-62.

[1]Aaron Wildavsky, *The Politics of the Budgetary Process*, Boston, Little, Brown and Company, 1964, p. V.

diverse purposes, and are being followed with varying degrees of success in different countries. These include line-item budgeting, performance budgeting, programme budgeting or planning, programming, budgeting system (PPBS), zero-base budgeting (ZBB), sunset legislation, etc. It is proposed to discuss, in the following sections, the feasibility for the application of these techniques in the conditions obtaining in India.

THE HISTORICAL BACKGROUND OF THE INDIAN BUDGETARY SYSTEM

It was in 1860 that Sir James Wilson, the first finance member of the Governor-General's Council introduced the first budget in the Government of India. The British introduced in India a highly centralised system of financial control. This was in line with their policy of consolidating their hold on the country. The British also wanted to introduce order and discipline in the system of financial administration which had been quite loose during earlier regime of the East India Company. A centralised system of financial control suited their interests, which, based on lack of trust of the functionaries, was made a characteristic feature of the colonial administration.

A striking feature of the system of financial control as introduced by the British in India was that it was centralised in the department of finance. Primarily, it was the finance department which was responsible for protecting the interests of economy and financial propriety in government. The department of finance used the budgetary system for exercising the necessary financial control over the spending departments. At the stage of budget formulation, it reviewed the proposals of the administrative departments by carrying out a thorough pre-budget scrutiny of their expenditure proposals from the point of view of economy and to examine their consistency with the accepted policies of the government.

The finance department did not restrict its control to the pre-budget scrutiny stage only. It got another opportunity for a detailed scrutiny of the expenditure proposals after the budget was passed and when references came to the department for expenditure sanctions before the administrative authorities could incur the expenditure. The inclusion of an item of expenditure in the budget did not by itself give authority to the concerned administrative agency to spend money on it. The administrative authorities had to approach the department of finance again with a full justification of the proposed expenditure, and to obtain its concurrence to the issue of expenditure sanction.

Paul H. Appleby, who was invited by the Government of India to review the Indian administrative system, was struck by its highly centralised character. He was also surprised by the way in which matters of

detail continued to be referred to the central agencies for concurrence even though the decisions regarding budgetary allocations had already been made. As remarked by him:

> The budget provides an excellent example; it is not determined in fact when enacted, but is actually being made day after day throughout the year. Detailed control after the fact of general determination has the effect of delaying, frustrating and even nullifying decisions made earlier at the highest levels.[2]

Under the Indian budgetary system, the position till the launching of the recent delegation schemes was that the executing agencies could not proceed with the implementation of the budgeted programmes without securing itemised expenditure sanctions from the ministry of finance. The rules of business, from the very early days of the British rule, had provided that no proposal involving expenditure could be taken up for execution without the concurrence of the department of finance. These rules continued to exist after the reforms of 1919 and of 1935. They have survived even in the present system which came into existence after the promulgation of the Indian Constitution in 1950.

In the rules framed by the President of India "for the more convenient transaction of the basiness of Government of India" under Article 77(3) of the Constitution, the ministry of finance has been assigned a special position in regard to the management of the financial affairs of government. However, there is a provision in the rules that they are exercisable subject to general or special orders made by the ministry of finance. Under this provision, the ministry can delegate financial powers to the administrative ministries/departments and share its responsibility for financial control with them. The various types of financial delegations made by the ministry of finance to the administrative authorities flow from this provision and the rules framed on the subject, like the "delegation of financial powers rules", derive their authority therefrom.

LINE-ITEM BUDGETING

The manner in which a budget is arranged reflects to a large extent the thinking of the budget administrators. The form of budgeting matters importantly in the kind of calculations that enter into and the outcomes expected from the budget. Its classification brings out the main purposes it is required to serve.

[2]Paul H. Appleby, *Re-examination of India's Administrative System*, New Delhi, Manager of Publications, Government of India, 1956, p. 50.

Different types of budget classifications have been evolved to serve diverse purposes, such as, objectwise classification, economic classification, programme or activity classification, etc. Objectwise or line-item classification serves the purposes of financial accountability and ensuring legality and regularity of expenditure.

In India, traditionally, the management of on-going activities and control of expenditure have been given priority in the process of budget formulation and execution. The budget had been used primarily to keep spending in check. It was employed for central control over inputs, such as salaries, wages, travel expenses, materials and supplies, machinery and equipment, tools and plant, etc.

Accordingly, it was the line-item budget which was introduced in India by the British and continued to be followed for over a century. This type of budget laid emphasis on the items of purchase on which expenditure was to be incurred and did not highlight the purpose of expenditure. It was evolved as a plan which told the legislature the agencies for which funds were required, and, within these allocations, the details of such expenditure, called heads of account.

This type of budget was used as the basis for ensuring legislative financial control. It suited the needs of the Government of India because it was engaged throughout this long period of nearly a hundred years in a few activities only, namely, collection of revenues, maintenance of law and order, and some economic activities primarily for the protection and furtherance of British trade, like development of transport and communications. The financial control was sought to be exercised by controlling the inputs, and the budget was used for itemised control over objects of expenditure.

PERFORMANCE BUDGETING

The need for modernising the budgetary system was keenly felt in India when the country launched upon planned development under successive five year plans. The traditional budget formats and processes were considered as unsuitable for a proper implementation of governmental programmes. To cite from the writer's book:

> The budget as conventionally prepared emphasized the financial aspects and did not interrelate financial outlays with physical targets and achievements. Accordingly, it proved deficient as a tool of management and as an instrument for evaluating performance.[3]

[3]K.L. Handa, *Programme and Performance Budgeting*, New Delhi, Uppal, 1979, p. 176.

It was, therefore, felt that the system of budgeting should be such as would provide adequate information regarding the programmes and activities of government, as to how efficiently and economically they are implemented and the results that flow therefrom, indicating the relationship between inputs and outputs. The budget should provide clear information on what the government proposed to do, how much of it, at what cost, and with what results.

In the context of the changed needs it was though that the technique of performance budgeting could provide the necessary management device, as under it the financial and physical aspects of a scheme are kept together right from the beginning of the proposal to its finale. The Administrative Reforms Commission, constituted by the Government of India, in its report on *Finance, Accounts and Audit* suggested that performance budget should be prepared in the following manner:

> A programme and activity classification should be made for each department or organization selected for the purpose of performance budgeting. Besides presenting the financial needs of those programmes and activities, the expenditure should be classified in terms of object, *e.g.*, establishment. This should be followed by a narrative explanation justifying the financial requirements under each activity. This explanation should include information on targets, achievements, relevant workload factors, comparative performance over the years, etc. All this will constitute the performance budget. It should be accompanied by the demands for grants which will continue to serve as the medium through which appropriation control is exercised.[4]

The Government of India since 1968 has been gradually introducing performance budgeting, and by now most of its departments are covered under this scheme, including all its developmental departments. Many State Governments have also been preparing performance budgets for their selected departments. The exercise in formulating a performance budget by a government department has, generally, involved the conversion of the existing demands for grants into the format of a performance budget with whatever data that could be procured.

According to the concept of performance budgeting, the annual budget is in essence a work plan specifying the programme targets to be achieved by the agency concerned during the financial year. It emphasises the purposes for which funds are provided. Performance budget is a tool of management, which correlates the physical and

[4]See, Government of India, Administrative Reforms Commission, *Report on Finance, Accounts and Audit*, New Delhi, Manager of Publications, 1968, pp. 7-8.

financial aspects of each programme and activity by establishing a proper relationship between outputs and the corresponding inputs

The entire scheme of performance budgeting has to operate within the framework of clearly defined objectives which are sought to be achieved through the successful implementation of the various programmes and activities undertaken by the concerned department or agency. A functional classification of the budget is necessary under the system of performance budgeting. It means that the budget presentation of public expenditures should be in terms of functions, programmes, activities and projects. Such a classification facilitates programme management and the measurement of physical achievements of activities as related to the costs incurred on them.

As stated earlier, performance budgets being prepared by the various departments are, by and large, conversion of demands for grants into a new document. A performance budget is presented as an additional information document but is not used for operational purposes.

Performance budgeting has a great potentiality to be used as a management tool in India for an efficient and economical implementation of governmental programmes and schemes. For achieving this, the scheme of performance budgeting needs to be operationalised by taking whatever measures become necessary for the purpose. The administrative system in which such a scheme has to operate needs to be attuned to suit its successful working. The necessary reforms and improvements should be brought about to facilitate a proper operation of the scheme of performance budgeting.

The rationale of functional classification in a performance budget is to establish correlation between the physical and financial aspects of each programme and activity. The output of a programme/activity in terms of physical targets has to be related to the inputs required which are translated into financial terms and shown as the budget provision asked for the implementation of the programme/activity. In a scheme of performance budgeting, therefore, it is essential to set physical targets for accomplishment in respect of each programme and activity to enable working out of corresponding financial estimates for incorporation in the budget. The working of the system of performance budgeting depends importantly on the techniques evolved for the measurement of output in relation to inputs. The system envisages selection and development of suitable work measurement units, norms, yardsticks, standards, and other performance indicators for measuring the physical quantum of the work proposed to be done or services to be rendered. These measurement norms are essential in deciding as to what is the proper relationship between the resources to be utilised and the results proposed to be achieved. These are also necessary to provide detailed justifications for the budget provisions asked for, and to furnish a

scientific basis for the quantum of work proposed to be undertaken for the completion of an activity.

It is important that the measures of work devised are realistic and acceptable to the various participants of the activities. They must be acceptable to the operating officials whose work is to be evaluated in terms of these norms. They must also be acceptable to the higher management levels who would be evaluating the performance of the executing authorities by using these norms. Also, such norms or measures of work should be acceptable to the authority responsible for scrutinising and approving budget estimates framed on the basis of these norms. A complete understanding of the nature of work is necessary before standards of performance are set. These standards need to be related to the local conditions and not transplanted from other different economic systems.

Another area requiring attention is the accounting classification adopted by the government, which should be such as would adequately serve the objectives of performance budgeting. The various purposes required to be served by accounts can be grouped under management and accountability functions. Whereas the management function can be served best by classifying accounts in terms of functions, programmes, activities, and projects, the purpose of financial control and accountability as achieved better through itemwise control over expenditure facilitated by objectwise classification. The Government of India introduced, from April 1974, a revised accounting structure which attempts to serve the purposes of management as well as the requirements of financial control and accountability. Under this scheme, a five-tier classification has been adopted, *i.e.*, sectoral, major head, minor head, sub-head, and detailed heads of account.

The revised classification of accounts has provided the necessary facility for monitoring and analysis of expenditure on functions, programmes, and activities to aid the management function. However, there are certain constraints to be recognised in developing a system of accounting to support a successful operation of the scheme of performance budgeting. Government accounting is done on cash basis which makes it difficult to know the entire cost assignable to an activity. This creates problems in the application of cost control techniques. Also, the present structure of financial accounts is not adequate to serve the purposes of management. The accounts classification is not designed to relate to cost centres. Hence, it is difficult to allocate cost to a responsibility centre and to evaluate actual cost against standard cost. The new classification of accounts in terms of functions, programmes, activities, etc., therefore, needs to be improved further to provide for a subsidiary set of accounts to correspond to cost centres and to facilitate responsibility accounting.

Among the various important issues to be resolved satisfactorily for a successful operation of a scheme of performance budgeting is also 'delegation of financial powers'. A performance budget can lead to the achievement of results only when the various levels of management in the organisation perform and accomplish their tasks. Their involvement, in a meaningful way, in the formulation of the performance budget should inspire them to achieve its efficient implementation. The preparation of performance budget at each level in the organisational hierarchy results in assignment of responsibilities to different levels of management. This ensures better accountability of these responsibility levels against their budgeted plans, tasks and targets. The accountability for assignments would, of course, require provision of facilities necessary for the discharge of functions by the various responsibility levels. One such important facility is delegation of financial powers.

A decentralised responsibility structure under the scheme of performance budgeting necessitates delegation of financial powers down the line, commensurate with the responsibilities to be discharged at various levels. Adequate delegations are necessary for an efficient discharge of responsibilities at the various levels of management. In the Government of India, delegation of financial powers has been increasingly made, starting with the delegation scheme of August 1958, and followed by other delegation schemes introduced in June 1962, October 1968, April 1975 and January 1978. To facilitate the exercise of delegated powers by the administrative ministries/departments, a scheme of integrated financial adviser was also introduced from October 1975.

Whereas increasingly greater delegations have been made from time to time to the administrative authorities, and the inadequacy of delegations wherever it exists can be further taken care of, the issue which has assumed importance for debate is why the delegations after being made are not exercised by the delegatees in many cases. Unless the delegations are used by those to whom they are given, the very purpose of a scheme of delegation is defeated. It, therefore, becomes important to identify the factors which inhibit the exercise of their powers by the delegatees. Whereas adequate delegations commensurate with responsibilities are essential, it is equally important that a proper environment and the necessary administrative culture are created to promote and facilitate the actual exercise of these delegations. The various factors inhibiting the use of powers by the delegates should be sought to be removed.

A performance budget is a work plan which expresses targets for achievement in respect of various responsibility levels, based on accepted norms and standards. Measurement of actual performance both in physical and financial terms in relation to the budgeted plan is an extremely important aspect in the use of a performance budget. This,

however, needs to be done in a manner as would help decision-making and control at the various levels of management. In this context, designing a meaningful information and reporting systems assumes vital importance.

The technique of performance budgeting can be usefully applied in India if the related matters, as discussed above, are attended to properly and the necessary reforms implemented in the true spirit. A performance budgeting system introduced in an organisation should not stop at the preparation of a performance budget document rather it should be fully operationalised for achieving efficiency and economy in the execution of the various programmes, activities, schemes, and projects of the organisation.

PROGRAMME BUDGETING OR PPBS

Programme budgeting or planning, programming, budgeting system (PPBS) is a technique which is considered to provide a suitable methodology for the allocation of funds in the budget. This is based on analytical studies directed to an assessment of alternative means for the achievement of the specified objectives. This system involves defining the various programmes, identifying the inputs required with a calculation of the related outputs expected, and trying to obtain the lowest possible input-output ratio. The presumption is that by incorporating a scheme of planning in the budgetary process, the new technique of PPBS would help employ public resources in such a manner as to achieve the best results. The allocation of budget resources according to cost-benefit/effectiveness analysis is considered to achieve the best possible input-output relationship.

Therefore, programme budgeting or PPBS emphasises the planning aspect of budgeting for selecting the best out of a number of available programmes, and for optimising the choice in economic terms while allocating funds in the budget. Programme budgeting is thought to derive its core ideas from economics and systems analysis. It treats budgeting as an allocative process among competing claims to be conducted by using the relevant planning techniques.

This type of budgeting techniques is not suitable for application in India because the necessary trained manpower capability is difficult to be developed in each department for a long time to come for carrying out the required analytical exercise, and also the necessary informational technology and other aids for the purpose of these exercises are not available to each department, and there are certain serious conceptual and practical problems involved in working such a scheme. Despite the various difficulties in defining the scope of cost-benefit/effectiveness analysis and the problems of measurement, a complete merging of the

planning function with budgeting conveys the idea that a theory of budgeting can be built by incorporating the various stages of policy analysis and planning into the planning-programming-budgeting system. The implication then is that budget allocations can be determined by the theory so constructed.

It may be pointed out that in a democratic polity, the budget allocation process cannot leave aside the political forces and interest groups which keep pressing their claims and demands for a share in the public purse. A theory of budgeting which seeks to settle resource allocations on the basis of analytical techniques alone might serve academic interests, but is bound to be out of place in the real world.

As maintained by Wildavsky, a normative theory of budgeting, to be more than a mere academic exercise, must actually guide in the making of resource allocation decisions. The items of approved expenditures provided for in the budget and spent must, in a large measure, conform to such a theory for it to have any practical effect. This would, however, be tantamount to requiring virtually all the activities of government to conform to the theory of budgeting because the bulk of what the government does has to be paid through the budgeting process. Therefore, any theory of budgeting, embodying the criteria for determining budget allocations, is nothing less than a theory which prescribes what the government ought to do. This makes a normative theory of budgeting a comprehensive and specific political theory which prescribed what the government's activities ought to be at a particular time. As remarked by Wildavsky:

> A normative theory of budgeting, therefore, is utopian in the fullest sense of that word: its accomplishment and acceptance would mean the end of conflict over the government's role in society.[5]

It is unlikely, therefore, that budget allocation can be finally decided on the basis only of analytical studies incorporating techniques of systems analysis, cost-benefit analysis and cost-effectiveness analysis. Nevertheless, there is no gainsaying the utility of analytical studies as important aids to decision making and for determining priorities among equally acceptable investment projects. What is sought to be made out is that the various types of analytical techniques would have a limited role in the budgetary allocation process. In a democratic society, such techniques cannot conclusively settle the allocation of resources as among the various competing projects. They can at best be a useful aid in the process of decision-making which involves other considerations also. The final decisions, of course, have to rest on the political

[5]Aaron Wildavsky, *op. cit.*, pp. 128-29.

process obtaining in the country. There cannot, therefore, be any such thing as a normative theory of budgeting as the final arbiter on budgetary allocations. There needs to be a compromise and a proper match between analytical studies and the various other considerations.

A complete tying of planning function with budgeting is also not advisable because of certain important differences between the two processes. Planning, of course, has to precede budgeting. Also, a good system of budgeting is one which reflects as many planned programmes as financially possible and politically feasible. Whereas there is need for a close coordination between planning and budgeting, the two by their very nature have to be separate processes. Planning partakes more of the nature of a consultative process. Budgeting, on the other hand, is done, both in its formulation and execution, within certain constitutional, legal, and administrative constraints. All this is, however, not to deny the complementary role of planning and budgeting, which is of crucial importance especially in developing countries. As stated in a United Nations document:

> In a developing country with a mixed economy, where formal operative planning takes place with respect to the public sector, the budgetary system plays a very important role in the implementation of public sector development programmes. The planning and budgetary processes are essentially complementary to each other but in actual practice, the relationship between them has often been weak and tenuous.[6]

While recognising the complementary nature of planning and budgeting and also emphasising the importance of linking closely the activities under them, what is sought to be made out here is that they cannot be tied into one and the same process of planning and budgeting. In fact, in most countries, the tasks of planning and budgeting are separately undertaken by different groups of personnel in distinct organisational units. Whereas, under a budget, programming is done on an annual basis, planning has a longer time perspective.

A government budget is generally adopted for one year. This annuality of the budget is just an auxiliary device. But as it has come to be so for practical reasons, the budget allocations for programmes need to be planned for each fiscal year. The preparatory work which feeds into the budget allocation process, in order to remain close to reality, cannot be extended much beyond six to twelve months before the commencement of the budget year. If planning, based on analytical

[6]United Nations, *Government Budgeting and Economic Planning in Developing Countries*, New York, UN Publication, 1966, p. 15.

studies, is fully tied to the budgetary process, the various studies needed to decide priorities among the alternatives would be required to be completed in about a year's time Obviously, this would not be possible in the case of most of the bigger programmes involving extensive and intensive cost benefit/effectiveness studies.

Planning, therefore, by its very nature, has to be undertaken separately from the budgetary process. However, the results of planning have to be fed to the budgetary process as and when the programmes are accepted for implementation. In other words, planning, to be meaningful, requires an effective integration with budgeting through appropriate institutional, organisational and other arrangements; as in India, one way of achieving this is by cooperation and coordination between the Planning Commission, the Bureau of Public Enterprises, the administrative ministries, the ministry of finance and other concerned departments through the agencies of expenditure, finance committee and the public investment board. But the two processes, *i.e.*, planning and budgeting, need to be conducted separately.

It may be pertinent to cite here the following comments of Wildavsky on the system of planning, programming and budgeting as introduced in the United States in 1965, under which planning and policy analysis functions had been tied to the budgetary process:

> PPBS discredits policy analysis. To collect vast amounts of random data is hardly a serious analysis of public policy. The conclusion is obvious. The shotgun marriage between policy and budgeting should be annulled.[7]

Therefore, planning and budgeting should be kept as two distinct processes. However, after the plan priorities have been settled and programmes formulated by the planning agency, the budget may be used as a proper instrument for making resource allocation decisions for the planned programmes on a year to year basis, considering the resource position for each year.

The recommendation for keeping the planning function with a separate agency does not imply that the participation of the administrative departments is not necessary in the planning process. On the contrary, it may be emphasised that the planning agency needs close cooperation from the administrative departments for working out various proposals under the plans. The contribution of the implementing authorities is of crucial importance in framing realistic and workable plans. What is, however, sought to be suggested is that the bulk of the analytical studies would need to be conducted as part of the planning process separate

[7]Aaron Wildavsky, *op. cit.*, p. 205.

from the budgetary process. Programme budgeting or planning-programming-budgeting system is, therefore, not feasible for application in India in the conditions as at present prevailing in the country.

ZERO-BASE BUDGETING

Zero-base budgeting was evolved in 1969 as a tool for planning, budgeting and control. It was developed originally by Peter A. Pyhrr at Texas Instruments. Jimmy Carter adopted the system for the first time in government when he was Governor of Georgia and used it in the formulation of the 1972-73 budget. Also, as President of the United States, he made use of zero-base budgeting in his budget for the fiscal year 1978-79.

The basic feature of a zero-budget is that the departments, while preparing their budgets, should not take anything for granted and, therefore, should start on a clean slate. The budget making for the ensuing year should be started from ground zero instead of treating the current budget as the base or the starting point. The concept of zero-base budgeting implies that all activities of the organisation should be viewed afresh and priorities among competing claims for allocation of funds settled on the basis of some analytical evaluative technique, like cost-benefit analysis.

There are certain basic requirements for developing a zero-base budget, which are: (*i*) identification of decision units, (*ii*) describing each decision unit in terms of decision packages, (*iii*) evaluating and ranking all decision packages by using the analytical technique of cost-benefit analysis, and (*iv*) developing the budget requests by ranking decision backages on the basis of their relative projected performance, and allocating resources to activities or decision packages by utilising hierarchical funding cut-off levels. Zero-base budgeting, thus, requires a complete re-examination of all programmes and activities afresh instead of following the incremental approach to budgeting.

In a system of zero-base budgeting, the existing programmes and activities are to be reviewed and examined in the same detailed manner as the newly proposed ones. The system requires providing the necessary justifications for all programmes, activities, or decision packages with each new budget year so that the scarce resources available may be allocated in an optimum manner. The scientific techniques used for analysing the cost-benefit relationship of various available alternatives help in presenting choices for decision-making so as to enable optimising allocation of fund.

Zero-base budgeting requires a highly professionalised staff, well-versed in techniques like cost-benefit analysis, being available to each

agency where such a type of budgeting is introduced. As in the case of programme budgeting, zero-base budgeting also involves conducting the planning process as part of the budgetary process, with all the associated conceptual and practical problems as have been discussed in the earlier section. A highly sophisticated information system which becomes a necessary adjunct of a system of zero-base budgeting would take very long to develop in most of our government departments and agencies. There is also generally a bureaucratic resistance to a major change in any aspect of the administrative system. Zero-base budgeting being a radical change from the conventional budgeting practices, is likely to encounter strong resistance from departmental officers.

Zero-base budgeting may be more suitable for industrial organisations and commercial enterprises. But its application to governmental organisations which do not possess the necessary informational and analytical capabilities required for a successful operation of zero-base budgeting may create more problems than what it is calculated to solve. In any case, zero-base budgeting is not suitable for application in the present day conditions of India or in the developments envisaged for the near future.

SUNSET LEGISLATION

Sunset legislation is a formal process of policy review for terminating programmes not desired. It embodies the concept of self-retiring government programmes by providing for the termination of the statutory authorisation of programmes. This way, the sunset legislation ensures economy in government expenditure by making it possible for the elimination of those programmes which have outlived their purpose and lost their utility. This is achieved by placing time limits on government programmes in the legislative enactments themselves and providing for their automatic termination on the prescribed dates unless affirmatively recreated by the legislature after conducting a detailed review.

It started with the enactment of Colorado's Sunset Law in 1976 which incorporated the provision for self-retirement of programmes according to prescribed schedules. The idea of sunset legislation was soon after caught by the United States Congress and most States in that country, which enacted similar legislations in the years that followed.

In government, it is very difficult to initiate a programme because no one person generally assumes full responsibility for the purpose and the necessary decision-making is fragmented amongst various bodies. But, once a programme forms part of the budget and gets started, it becomes still more difficult to drop it even when it has lost its purpose. The sunset laws which provide legislative authorisation for the termination of redunant programmes get their justification from this basic difficulty

of a government to pilot elimination of a current programme.

The basic support for sunset legislation is provided by the argument that as the old programmes become redundant, ineffective and start being managed inefficiently without any relevance to the original purpose, they should be eliminated, making funds available for new programmes. This would enable reallocating scarce resources of government on a continuous basis, to ensure economic efficiency and administrative rationality. This would also help avoid unnecessary proliferation of government activities.

Sunset legislation also seeks to shift major responsibility for evaluating a programme from the executive wing to the legislature thereby overcoming the resistance which would generally be met within the executive branch while terminating a current programme. The priorities among the various ongoing and new programmes can, thus, be weighed more objectively by the legislature playing an active role in deciding upon budget authorisations.

The application of sunset principles in India is beset with many difficulties. In the parliamentary democratic form of government which obtains in India, the Constitution has provided initiative in financial matters to the executive wing. Any adverse vote by parliament on a proposal submitted by the government may result in the cabinet resigning from office. Also, there are no separate legislative committees created in Indian parliament to review and revise the budget demands submitted by the various departments of the government each year, which is the case under the United States system. Moreover, unlike the United States Congress, the Indian parliament has not been adequately staffed with trained personnel to provide the required support for carrying out detailed analytical exercises, such as systems analysis, cost-benefit analysis, cost-effectiveness analysis, etc., for a total evaluation of programmes. Therefore, for various reasons, sunset laws which have been claimed to have received enthusiastic welcome in the United States are not feasible for application in India.

What will suit the present day Indian system and very much needed also is zero-base planning of programmes. It is suggested thereby that each on-going programme should be thoroughly examined and evaluated periodically, say, every five years, to justify afresh its further continuance. Also, a system needs to be institutionalised, that those of the programmes and projects which have lost their utility and, therefore, their further continuance, are eliminated. It may be mentioned that programme evaluation reviews are already being conducted by some agencies in India. It is, however, suggested that programme evaluations should be done as a regular part of the system at definite intervals by using the principles of zero-base planning and by employing the relevant analytical techniques.

CONCLUSION

Line-item budgeting is suitable for financial accountability and ensuring legality and regularity of expenditure. This type of budgeting, however, emphasises objects of expenditure without highlighting the purpose to be accomplished. Performance budgeting serves the purpose of correlating the financial and physical aspects of each programme and activity by establishing a proper relationship between the inputs to be used and the corresponding output. It is useful as a tool of management for achieving efficiency and economy in the implementation of programmes/activities. It can be successfully applied in India provided certain related matters, like evolving scientific and realistic norms and standards, structuring of accounts classification, delegation of financial powers, designing and operating a proper monitoring system, etc., are attended to and the necessary reforms introduced.

Programme budgeting or PPBS, and zero-base budgeting are not feasible for application in India because both these techniques require planning, based on analytical studies, to be made an integral part of the budgetary process for deciding on allocation of funds. This, for various reasons, is difficult to be achieved in a democratic political set-up as it obtains in India. Sunset laws provide legislative device for self-retirement of programmes according to prescribed time limits unless affirmatively recreated by the legislature after conducting detailed evaluation of these. This type of system is also not feasible in India because of certain basic differences, constitutional and others, between the position and powers of the Indian parliament and the United States Congress. □

Financial Control over Expenditure in the Central Government*

M.S. Ramayyar

THE FINACIAL rules of the central and state governments postulate that the financial powers of government which have not been delegated to any other department or authority vest in the Ministry of Finance/Finance Department. This provision is derived from the codes that were in force prior to the reforms of 1935 and which applied both at the centre and the states. It is now deemed to have been made under Articles 77(3) and 166(3) of the constitution which authorise the President and the governors to make rules for the convenient transaction of the business of the Government of India and the governments of the states. The delegations made to administrative departments and subordinate authorities, which till recently were very limited in scope, are contained in the Financial and Service Rules, Book of Financial Powers and various codes and orders issued from time to time by the central and state governments.

The limited scope of the delegations to administrative departments and subordinate authorities did not attract special attention so long as the bulk of government expenditure related to administration with a pronounced emphasis on law and order and defence. In such circumstances provision in the budget estimates did not also present any special difficulties. With the adoption of the policies of a Welfare State and the consequent need for meeting the requirements of planned development with a view to the speedy and efficient execution of schemes and projects and utilisation to the maximum advantage of the financial resources of government, the problem of removing bottlenecks and bringing about improvements in public administration to better fit it for the new role has latterly come in for attention and comments from time to time.

II

In April 1951, Shri Gorwala in his Report on Public Administration observed :

The Finance Ministry, it is said, centralises in itself the

*From *Indian Journal of Public Administration*, Vol. V, No. 1, 1955, pp. 19-39.

power of sanction, and even for small amounts of expenditure the administrative departments have to go to the Finance Ministry.

He suggested that the possibility of enlarged delegation should be investigated. He deprecated unnecessary interference either by the Finance Ministry with administrative ministries or by administrative ministries with heads of departments. He advocated that officers chosen for the Finance Ministry should have some experience in administrative ministries or appointments.

Two years later, *i.e.*, in 1953, Dr. Appleby in his "Report of a Survey of Public Administration in India" drew attention to "an astonishing lack of capacity and/or facilities for administrative delegation" in the existing structure. He observed that "Financial control is more effective and more appropriate, leaving within wide limits the deployment of money available subject to administrative discretion which is essential to responsibility." He deprecated "too much control of detail, too much preoccupation with 'saving' rupees and too little with larger effectiveness" and was concerned that "Review . . . was too much in the hands of persons remote from action and programmatic realities". He thought that there was too much scrutiny before the fact and too little systematic review and scrutiny of action after the fact.

Dr. Appleby in a later report in 1956 "Re-examination of India's Administrative System with special reference to administration of Government's Industrial and Commercial Enterprises" pleaded for more delegation to subordinate programme agencies and considered that the need for delegation of powers was the worst shortcoming of Indian Administration, that delegation enlarges and enhances responsibility, that delay is highly wasteful, retards plan objectives and is particularly tragic when it is based on triviality or downright ignorance, that the primary responsibility of Finance should be to encourage and stimulate good budgeting, that review should be high level and elevated to concentrate on matters of real importance and not be petty and frustrating, that the Ministry of Finance should decide broadly how much of government's limited funds can be made available for a particular programme and should have little further role in the specific allotment of funds to various parts of the programme, that adequate finance and personnel staff should be provided wholly responsible to the management and programme minister and financial and budgetary competence within the paramount ministries developed. He repeated his criticism that there was too much sharing of responsibility before the fact and too little review in appropriate terms focusing attention after the fact.

The Estimates Committee in its Ninth Report 1953-54 on admi-

nistrative, financial and other reforms, among other things, made the following recommendations regarding the responsibilities of the Ministry of Finance *vis-a-vis* administrative ministries in regard to approval and execution of schemes :

> After a scheme is concurred in from the financial point of view by the Ministry of Finance, the detailed execution of the scheme and spending of money thereon should be the responsibility of the administrative Ministry concerned which should also be given power to vary or alter the amounts under the sub-heads of the scheme so long as the total outlay is not affected.
>
> "After the administrative Ministry and the Ministry of Finance have approved the scheme, it shonld be included in the Budget Estimates of the Ministry concerned; and thereafter there should be no further sanction or embargo on reappropriation within the various sub-heads of the scheme so long as the total amount of the scheme is not exceeded. . . In case the plan has to be revised and further money is required, the concurrence of the Ministry should be obtained before the additional money needed for the scheme is included in the Budget or Supplementary Estimates.

Even before the issue of Dr. Appleby's Second Report the problem of delay in the execution of projects again got highlighted by recommendations to the Prime Minister made early in 1954 by Shri Asok Chanda, the present Comptroller and Auditor-General, who was then Production Secretary. Proposals on similar lines were also made by him in an Appendix to the Central Government Audit Report (Civil) 1955 and have been dealt with in great detail by the Public Accounts Committee (Second Lok Sabha) in their Eighth Report (1957-58).

The recommendations made by the Comptroller and Auditor-General were :

(*a*) The budget should continue to be compiled on the present basis but should be considered as only the budget plan to give the Parliament a broad picture of the government's scheme of expenditure. Demands for grants should be based on:

(*i*) standing charges, including maintenance;
(*ii*) expenditure on current projects; and
(*iii*) a small provision for each new project.

Supplementary demands should be presented as and when schemes mature sufficiently and are ready for execution.

(*b*) Financial scrutiny should be in two parts:

(*i*) Broad and overall scrutiny located in the Finance Ministry; and
(*ii*) Detailed scrutiny, at expert level, located within the administrative ministries.

(*c*) The administrative ministries should be provided with internal Financial Advisers drawn from a panel of officers with financial experience (as approved by the Finance Minister). Technical advice should be made available by suitable adjustment in the strength of the present Industrial Advisory and Development Wing under the administrative control of the Commerce and Industry Ministry. This organisation should be treated as a common pool for purposes of giving technical advice to the administrative ministries.
(*d*) The Planning Commission should fulfil its responsibility of reviewing quarterly, the progress of projects included in the Plan, in consultation with the administrative ministries concerned. Default or failure should be brought to the notice of the Chairman, Planning Commission, for such action as he may consider appropriate.
(*e*) In lieu of the Centre rendering financial aid to the states for a proportion of the expenditure in *all* the approved schemes, they should accept full responsibility for a specified number of such schemes, up to an equivalent amount. Programme Advisers should be required to report that the remaining schemes have been undertaken by the states out of their own resources.
(*f*) Detailed scrutiny of states' schemes should be discarded. The examination by the centre should be confined to :

(*i*) A broad administrative scrutiny by the ministry concerned and the Planning Commission, to ensure that they fall within the framework of the Plan; and
(*ii*) A broad financial review based, mainly on the certificate of the States Finance Department, that the schemes have been drawn up in accordance with standards, schedule of rates, etc., prevailing in the states and as are applicable to states' schemes.

(*g*) There should be de-concentration of authority in favour of Executive and Project Officers at all levels appropriate to their responsibilities and status.
(*h*) Internal Finance Officers should be associated with the

delegation of authority, wherever necesssary.

(*i*) A schedule of sanctions should be prepared by every officer for submission to the authority immediately superior to him, to enable a review of the manner in which delegated powers have been exercised.

He contemplated Finance Officers being interchangeable at suitable intervals, between Finance and other ministries which would assist the building up of a corps of officers who could fill both administrative and financial posts with equal facility. Finance Ministry was to continue to be responsible for rules and regulations and for observance of uniformity in the scales of pay and allowances and other conditions of service throughout the structure of government machinery. In the United Kingdom also, where similarly there has been a tendency to put greater responsibility on departments and relax Treasury control, it has been considered that those functions should continue with the Treasury. Prof. Samuel Beer in his *Treasury Control* observes as follows:

> While the Treasury has relaxed in detail its control over complements and gradings, control over the second main branch of establishment work, conditions of pay and service, remains absolute and comprehensive and, it may reasonably be argued, must so remain if a unified civil service is to be maintained. The responsibility of the divisions charged with these duties—Establishment General, Professional, Superannuation and Manning—is to see that no changes are made in the code of pay or other conditions of service in any part of the civil service except on the initiative or with the concurrence of the Treasury.

The problem of delegation of financial authority to administrative ministries and subordinate authorities and in what respects the control of the Ministry of Finance can be abridged, abated or more intelligently applied in the interests of greater speed in the execution of schemes has also been dealt with other problems by Shri Asok Chanda in his admirable and thought-provoking book *Indian Administration.*

The Public Accounts Committee generally endorsed the Comptroller and Auditor-General's proposals. They discountenanced the making of *ad hoc* lump provisions in the budget estimates. They held that in the case of a new project, no provision should be made in the budget estimates unless the Finance Ministry was satisfied on the basis of details available that there was reasonable expectation of expenditure materialising to the extent proposed. Once budget provision is made

and approved by Parliament, the administrative ministry should have freedom to incur expenditure without having recourse to consultation with the Ministry of Finance, so long as the budget provision is not exceeded and there is no change in the scope or total cost of the project.

The Estimates Committee in its Twentieth Report 1957-58 published about the same time expressed similar views as the following extracts from the summary of their recommendations will show:

> It is necessary that the administrative ministries should submit their respective schemes to the Ministry of Finance for inclusion in the budget only when all relevent details necessary for having a sufficiently clear picture of a particular scheme have been worked out. For this purpose the prospective schemes should be processed throughout the year so that the rush at the time of the preparation of the budget is avoided.
>
> It is necessary that a procedure should be evolved whereby the necessity of a further sanction after the budget should be done away with and also whereby an assurance would be given to the various authorities including the state governments that in respect of funds provided for approved projects, the unspent amount would be available in the next financial year.

III

It will be interesting to mention that in the United Kingdom also, since the time the Haldane Committee in 1918 reached the conclusion that "on the whole, experience seems to show that the interests of the taxpayer cannot be left to the spending departments", the progressive growth in the proportion of government expenditure to the national income and the fundamental part it plays in the economy, led to these interests being progressively entrusted to a partnership between the Treasury and the departments and grant of increasing responsibility to the spending departments. It came to be recognised that the person who was responsible, subject to the minister, for policy must also be the person answerable to the Public Accounts Committee for seeing that policy was carried out with due regard to economy. Thus the rule that the Permanent Secretary of the Department should also be the Accounting Officer got established by the late 1920s. The Permanent Secretaries are held responsible not only for the correctness and propriety of the expenditure of their departments but also for the efficiency and economy of their administration, and are required to ensure that the financial branches of their departments are so organised as to provide adequate control of the expenditure of the

funds for which he is responsible. As a corollary Treasury control is exercised in consultation with the departments on broad and general lines with a wide entrustment of responsibility to departments in matters of day-to-day activities. Even as such the Committee on Treasury Organisation under the chairmanship of Sir John Woods in 1950 said "that the time had come for some movement in the direction of greater delegation, particularly in relation to individual projects which form part of a settled programme". The Select Committee on Estimates (1957-58) in their Sixth Report—Treasury Control of Expenditure—agreed with Sir John Woods for "a move, but not a *dash* towards more freedom for Departments". It emphasised the importance of encouraging a sense of financial responsibility in spending departments at all levels. It agreed with Sir Warren Fisher that the Treasury should not act "as the single-handed champion of solvency keeping ceaseless vigil on the buccaneering proclivities of the Permanent Heads of Departments" but that the Treasury and the Accounting Officers "should work together as a team in the pursuit of economy in every branch and every detail of the public service".

It recommended an increase in the delegated financial authorities of spending departments particularly in relation to projects specifically forming part of agreed programmes or fully covered by previously determined totals of expenditure, provided that the following criteria are satisfied:

(*a*) that the expenditure forms part of a specific policy decision that has received Cabinet or Treasury approval or is a matter of detailed administration;
(*b*) that no significant economies have been secured in recent references to the Treasury within the limits to be delegated; and
(*c*) that either the raising of the financial ceiling will not remove the whole of a major field of departmental expenditure from the Treasury's control or will not remove their control over major production orders or other projects which form a significant part of the total expenditure of a department.

The Committee also recommended that unlimited power should normally be delegated to departments to incur expenditure, within the estimates, on minor projects and services. It favoured the delegation of full powers to all departments in respect of 'write-off' of losses, *ex gratia* and extra contractual payments but that periodical summaries of the ways in which these powers have been incurred should be made to the Treasury. It emphasised that even in the delegated field the Treasury has a continuing duty and should take continuous interest to see that departments have themselves effective methods of controlling

expenditure and are exercising that control with diligence. Treasury should also conduct reviews of delegated authority from time to time and not overlook the fact that static estimates for well-established services may merit as close an examination as rising estimates for expending services.

The Committee favoured a little more Treasury control on grants-in-aid and on the costs of procurement orders placed by the Ministry of Supply on behalf of the Service Departments. It conceded the Treasury's right to require all new items and new services to be referred to it for sanction even though the proposals may have been prepared by departmental officers who may have spent their entire working lives dealing with that subject or may relate to highly technical projects submitted by technical experts. Notwithstanding certain drawbacks in reliance on layman for sanctioning such proposals, the expert, they observed, is inevitably an enthusiast, with a deep conviction of the importance of his work; the Treasury layman is detached and can judge the proposal in the context of the claims on expenditure by other experts in other departments. It may also be beneficial to require the expert to justify his claim for money to a man of general common sense and broad understanding. Furthermore, it would be a mistake to assume that the lay critic is an ignorant critic. From the moment he comes into the division the good Treasury Officer will have steeped himself in the problems and experience of the department with which he deals.

Since this kind of criticism is frequently voiced in this country, the Committee's observations are of particular interest to us and should lead to a better understanding between the technical men on the one side and departmental men and the lay Finance man on the other as to their respective roles so that there may be no feeling of irritation or frustration on the part of the former when subjected to cross-examination by Finance on projects to which they have given the most careful scrutiny and the latter may be put on guard against meticulous control and too 'niggling' criticism of proposals.

IV

The observations of various persons and authorities regarding the crying need for wider delegations led the Government of India to consider early in 1955 details of further delegation to administrative ministries and subordinate authorities. Those delegations under the Book of Financial Powers, General Financial Regulations, Fundamental and Supplementary Rules, and Civil Service Regulations, etc., were all later embodied for convenience in a pamphlet issued by the Organisation and Methods Division of the Cabinet Secretariat in 1957 "Financial

and Cognate Powers delegated to ministries and heads of departments". While admittedly these enhanced delegations were helpful in speeding up day-to-day administration of departments, they were not conceived broadly enough to lead to greater efficiency and speedier implementation of schemes, programmes and projects. This was, however, done in August 1958 and a reference to it was made by the President in his address to Parliament on February 9, 1959 opening its Budget Session in the following :

> My Government have recently made certain important changes in regard to arrangements for budgeting and financial control over expenditure from the Civil Estimates in order to secure a speedier implementation of our development plans, the administrative ministries have been given wider financial powers to issue expenditure sanctions to schemes which have been included in the Budget estimates after scrutiny by the Finance Ministry.

The revised arrangements for budgeting and financial control provide as follows:

Regarding budget,

(*a*) Provision for standing charges and maintenance and repairs will continue to be made as at present. The administrative ministries will send the estimates to the Finance Ministry for scrutiny and acceptance and inclusion in the budget estimates.

(*b*) Proposals will be made for expenditure on temporary establishment and connected items like travelling allowance, contingencies, etc., as at present on the basis of broad estimates of requirements and sent to the Finance Ministry.

(*c*) For specific scheme and projects which have already been examined in detail by the Finance ministry and sanctioned, budget provision will be made on the basis of the estimated requirements of the administrative ministries under the usual sub-heads.

(*d*) For new works projects, budget provision will not be considered except for schemes for which administrative approval has been accorded. In the case of large projects, the scope and the cost of which have been accepted as a whole, administrative approval may be accorded in stages for different portions of the project, if necessary. The budget provision in any particular year will, however, be based on the actual requirements of the year. Provision

will be made under the usual sub-heads in the budget.

(*e*) For new schemes, other than purely 'works' projects, provision will be made in the budget only on the basis of a broad picture of requirements in suitable details furnished by the administrative ministries and accepted by Finance.

(*f*) No lump-sum provision will be made in the budget except for minor works and for petty temporary establishments. Where a new scheme is planned to be taken up in the budget year which has been accepted in principle and for which details necessary for budget provision under sub-para (*d*) or (*e*) above are not available, budget provision will be limited to the requirements for preliminary expenses and for such initial outlay as for example, on collection of materials, recruitment of skeleton staff, etc.

(*g*) To enable the Finance Ministry to make provision in the budget in accordance with sub-paragraphs (*b*) to (*f*) above and avoid rush of work in the budget season, the administrative ministries should regulate throughout the year the consideration of schemes for which budget provision in the next financial year would be required and put up their proposals to the Finance Ministry as and when they are finalised by them.

Regarding delegation of powers, the executive orders of August 1958 have been followed up by the promulgation in December 1958 of the "Delegation of Powers Rules, 1958". Subject to some general limitations wide powers have been given to administrative ministries. administrators and heads of departments. Their powers to create permanent and temporary posts and to incur contingent and miscellaneous expenditure have been considerably enhanced. Full powers have been granted for appropriations and reappropriations subject to the expenditure being within the scope of the grant with certain restrictions for prior consultation with Finance, as for example, if the reappropriation is from the primary unit 'Major Works' to any other unit, or if the reappropriation augments the provision under Pay of Officers or Establishment, or under the primary units under which provision is made for a scheme by more than 5 per cent or Rs. 1 lakh, whichever is less. Departments of the Central Government are empowered to sanction expenditure on any scheme, the total outlay on which does not exceed Rs. 50 lakhs. Departments have full powers to sanction loans and grants-in-aid in accordance with rules prescribed in consultation with Finance and general control of Finance regarding rates of interest and period of repayment of loans. Departments can enter into contracts or make purchases if the value does not exceed Rs. 25

lakhs or there are special features as negotiation or single tender up to Rs. 10 lakhs or for proprietary articles up to Rs. 5 lakhs and so on.

Powers for writing off losses have not been enhanced to the same extent as other powers as such cases do not directly affect the main object of speedier implementation of development plans and in the interest of efficiency it may be necessary for Finance to pay closer attention to them.

Periodical reviews of staff position of the ministries by the O & M Division of thc Cabinet Secretariat and the Economy Unit of the Finance Ministry are contemplated in these revised arrangements. In the United Kingdom the O & M Division is under the Treasury.

V

As part of the scheme of delegation of additional powers to ministries, officers of appropriate status are now posted to each ministry with such supporting officers and staff as may be necessary to give financial advice to that ministry. These officers are designated as Financial Adviser, Deputy Finacial Adviser or Assistant Financial Adviser as the case may be and have appropriate *ex officio* secretariat status in that ministry. These officers and their staff form the Finance Branch of the administrative ministry concerned and are employed solely on financial, budgetary and connected work. They are associated with the formulation of proposals for inclusion in the budget from their inception and consulted in all financial matters involving the exercise of the enhanced powers now delegated or matters requiring reference to the Ministry of Finance. They also assist the ministry in the control of expenditure against appropriation. It is open to the ministries to consult the financial adviser even in the field in which they at present exercise full delegated powers, but only those financial sanctions which are issued by ministries in exercise of the additional powers now delegated have to be endorsed to audit over the signature of any officer of the Finance Branch specified above. Sanctions issued by ministries under the powers previously exercised by them continue to be endorsed direct.

All cases in which the advice tendered by the Financial Adviser of the Ministry is not accepted have to be referred to the Secretary of the Ministry for orders, and if the Secretary also differs from the advice, the case has to be brought to the notice of the minister. A monthly statement of the cases, if any, where the Financial Adviser's views have not been accepted, giving a summary of the differences and the final decision is forwarded by the Secretary of the Ministry to the Finance Ministry, Department of Expenditure, for information, a copy bieng endorsed to the Comptroller and Auditor-General of India simultaneously.

The system of Internal Financial Advisers under the control of the Administrative Secretary in Civil Departments is a recent development. It recognises the need for the departmental secretary having individual responsibility for the efficient and economic administration of his charge and at the same time he is to discharge that responsibility, he should have informed any constructive criticism flowing from within his ministry from persons who are familiar to a degree that no external finance can ever be, with the peculiar difficulties of the administrative side of operating ministry which arise in the formulation and execution of schemes. Until such time as accounting responsibilities are decentralised and come to be vested in the administration, which involves intricate and complicated problems, the Internal Financial Adviser is expected to advise such technique as is best suited to enable him to watch the progress of expenditure. He should assist in the formulation of valid and defensible budget estimates, in projecting forward expenditures, in keeping expenditure within the limits of appropriation and give guidance in keeping expenditure up to the level to reach plan objectives. Since the system is modelled on that obtaining in the United Kingdom it would be best here to quote *in extenso* from an illuminating paper on "Departmental Financial Control" by Mr. A.S. Marre, Under Secretary for Finance, and Accountant-General, Ministry of Health, in the United Kingdom.

He says :

"The duties of the Finance Branch are on the whole wider and more interesting than those of the Accounts Branch; in particular it is its duty to see that financial considerations are given full weight in the formation of policy and to consult with the Treasury whenever necessary in so doing.

"What is meant by seeing that financial considerations are given full weight in the formation of policy? I think there are two main aspects :

(*a*) Taking into account not only the merits (including the cost) of a particular proposal and the other expenditure which the department has already incurred or to which it is committed, but also the general financial position of the country, is it reasonable to proceed with the proposal?

(*b*) If it is reasonable, is the proposal one which is calculated to secure the best return for the money to be spent?

"The job of the Finance Branch is to make sure that these aspects are properly considered before a final decision is taken. It is a positive, and not a negative, function. The Finance Branch does not, and should not, have the last word; but it should and does, see that

decisions are taken after full consideration of possible difficulties, alternatives and objections.

"It is not unfair to ask why a separate Finance Branch is necessary at all. Ought not the administrators themselves to be left to ask themselves the kind of questions mentioned in the preceding paragraph, and to settle the policy to be followed only when they have answered them satisfactorily? In theory, the answer is yes. In practice, it does not—at any rate not always—work out like that. An administrator may tend to be an enthusiastic advocate of a particular policy, so much so that he may tend not to attach sufficient weight to the cost which it involves He will often need some brake. Again, immersed as he is in the general issues of policy which arise, he has not always the time to familiarise himself with the full financial background to the department's activities or with the different kinds of financial yardstick which can be applid to various projects. Moreover, he may tend to allow his judgement to be influenced unduly by the Department's professional advisers, who may concern themselves little with questions of cost. The Finance Branch by its constant preoccupation with the one branch of work and by its regular contracts with the Finance Branches of other departments and with the Treasury, acquires a specialised knowledge which is bound to help it to make a positive contribution. For example, it can advise on the kind of statistics which ought to be got out if possible to measure the financial results of the policy; on the proper interpretation of such statistics; and on possible ways of improving them. From its independent standpoint, it may be able to point to alternative courses of action which might cost less money and be of little, if any, less value than a proposal which a particular Division is anxious to press on with. It may be able to anticipate difficulties or objections which the enthusiasm of the administrator may have minimised or overlooked. And it should always have prominently in mind the rate of expenditure already being incurred by the department as a whole, since the development of a service may well have to be postponed if the money is not available within the total sum voted by Parliament. The powers that be are sufficiently seized of the value of having a separate Finance Branch, to have given the head of the branch a special position not that in practice he much wants or needs to take advantage of that position—indeed it would be an admission of failure to secure sensible working arrangements within the department if he did.

"All this is not to say that financial consideration must be the preoccupation of the Finance Branch alone. It is the administrators who ultimately spend the money; and it is they who must be persuaded to save it. It is ineed an essential part of the job of the Finance Branch to keep the administrative divisions finance-conscious. The more they

succeed in this, the less troublesome will be the duties of the Finance Branch. In a recent paper, the Comptroller and Auditor-General suggested that the existence of strong Finance Branch might tend to weaken the sense of financial responsibility that should exist among administrators. That is not my own personal view. I think the two go largely together; and a strong Finance Branch and a strong sense of financial responsibility among the administrators is the ideal position to attain. Both sides have to work together as a team, with joint discussion from the very earliest stages of the development of policy, and if either overshadows the other too much the result is almost bound to be unfortunate. At the top of the department, administrative and financial responsibilities are joined together in the Permanent Secretary, and the closer the link between the officers in the different branches, the easier it becomes for him to discharge that responsibility.

"I would myself, with this in view, like to see more interchange between the administrative and Finance Branches. A sense of economy and financial responsibility cannot be the monopoly of any individual or branch, and the more people we can train to look at this as well as the other aspects of policy, the more useful it is bound to be.

"Regular contact is maintained between the Finance Branch and the Treasury. Apart from satisfying themselves that public money is being spent with strict propriety, the Treasury have the responsibility for doing, from the wider national standpoint, what the Finance Branch does within its own narrower field—that is, in particular, to try and ensure that value for money is being obtained in the policies being followed and that the resources made available to the department are being used wisely and prudently. This involves regular correspondence and discussion between officers of the Finance Branch and the Treasury, not only at Estimates time, when the detailed proposals of departments for the next financial year—put forward after the Finance Branch have vetted the proposals of the administrative divisions—are examined, but whenever, for example, a new departure from policy is proposed, whenever a new or unusual point of financial difficulty crops up, and whenever it is proposed to take any action involving expenditure greater than that within which the Treasury have authorised the department to act at its own discretion."

VI

It will be seen that the revised arrangements cover most of the field in which there has been criticism of late by various authorities. They, however, cover only civil expenditure. Enhanced delegations further down at various executive levels are also envisaged as an

essential part of the revised arrangements. Further, experience alone will show how far restrictions still in force over delegated powers can safely be removed. Even what has been done now marks a very material and significant change from the traditional system of financial control and has to be appreciated in the light of what the Prime Minister said in his Presidential address at the annual meeting of the General Body of the Indian Institute of Public Administration. He observed: "Any country which is traditionally minded in regard to various matters including administration, is doomed in a rapidly changing world."

As stated earlier, the revised arrangements are only in respect of civil expenditure. In respect of railway expenditure, by virtue of the inclusion of the Financial Commissioner for Railways as a member of the Railway Board, the Railway Board already exercises full powers of the Government of India in regard to railway expenditure. The Financial Commissioner has the right of direct access to the Finance Minister and can insist on the implementation of any decision of the Board involving financial issue with which he may not be in agreement being deferred till he has taken the directions of the Finance Minister.

In respect of Defence Expenditure, the Military Finance Department was even before independence organised differently from the Ordinary Branch. The Military Finance Department worked in close association with the Services Headquarters, in a number of respects more as the Internal Financial Advisers in the civil departments are expected to do now, though their allegiance was to the Finance Member. These arrangements by and large continue to be in force except that the Ministry of Defence have come to take an increasing share as intermediary between the Services Headquarters and the Finance consequent on the change brought about by independence in the position under which the Commander-in-Chief was the head of the three Services and also the Defence Member.

The following observations suggesting the extension to certain other departments of the prevailing system of financial control over Railways were made by Shri K. Santhanam, Chairman of the Second Finance Commission, while reviewing in the *Hindu* of June 12, 1958, the Twentieth Report of the Estimates Committee (Second Lok Sabha):

"Though, under the present Constitution, the Railway revenues are part of the Consolidated Fund of India, the separation convention of the British days continues to be in force. Under this convention, the Railway Minister is, subject to the overriding authority of the Cabinet, his own Finance Minister also. The Financial Commissioner for the Railways is a member of the Railway Board and, though directly responsible to the Railway Minister, he is at the same time entitled to refer to the Finance Minister any matter which deserves to

be considered in the wider context of the finances of the Government of India. This arrangement has worked well and enabled Parliament to scrutinise railway finances and shape railway policy. I cannot help wishing that the Estimates Committee had boldly advocated similar separation for the strictly central ministries, *viz.*, Communications, Production, Steel, Defence and Transport. If the presentation of documents and the budget discussion of the minstries are modelled on that of the Railway Ministry, the minister concerned functioning also as the Finance Minister of his department, Parliament will be able to get a grip over these vital ministries which deal with many crores of receipts and disbursements. It will also relieve the Finance Minister and his chief officers of the responsibility of watching through the entire Budget debates extending over months to the great detriment of their own special functions. There need be no fear that the general control of the Government of India will be affected as each of these budgets will have to be discussed and approved in the Cabinet and the Financial Commissioner will have the duty to report to the Finance Minister about important developments and the right to approach him in cases of doubt or difficulty."

A discussion of the pros and cons of the problem would require a paper by itself.

VII

Establishment control has three facets, *viz.*, (1) complements and gradings, (2) conditions of pay and service, and (3) organisation and methods. In the United Kingdom all these three functions are exercised in the Treasury. Over the first the Treasury has relaxed its control in detail. Over the second it is absolute and comprehensive. The third is advisory and binds neither departments nor for the matter of that other Establishment Divisions.[1]

In the Government of India the Ministry of Home Affairs enjoys a special position regarding 'Public Service'. It is responsible for regulating all matters of general applicability to all the services, in order to maintain a common standard of recruitment, discipline and conditions of service, etc. As regards the All India Services, which are organised and maintained jointly on behalf of the central and state governments, the Home Ministry is responsible not only for matters of a general nature but also for matters of detail. As all matters relating to service problems are settled only in consultation between the Ministries of Home Affairs and Finance, this leads to cross-

[1]Prof. Samuel Beer in *Treasury Control.*

references between these two ministries and consequent delays.[2] The entrustment of responsibility to the Ministry of Home Affairs over Public Services in general and the All India Services in particular was natural in the period before transfer of power when the primary responsibility of government was the maintenance of internal security. Whether the overlap of functions between two ministries and consequent delays in service matters cannot be avoided and the United Kingdom model followed deserves early and serious consideration.

At present a Special Reorganisation Unit of the Ministry of Finance works in close liaison with the O & M Division which is under the Cabinet Secretariat. The Special Reorganisation Unit has been set up with a view to "conducting an objective review of the organisation and strength of various ministries and other organisations. It carries out work studies involving an analysis of organisational structures, methods of work, etc."[3] When Dr. Appleby made his recommendation in 1953 for the establishment of an O & M Division, he considered that that division would be "charged with responsibility for giving both extensive and intensive leadership in respect to structures, management and procedures. At one level of highly technical and specific sort, it would give attention to work measurement, work flow, office management, filing systems, space arrangement and the like; at another level it would be charged with government structural studies and proposals". While admitting that where such an administrative citadel should be located is open to argument he thought "on the whole the general strength and scope of the Ministry of Finance would rather point to locating the 'O & M' office in it". As actually organised also it is for "paying intelligent and critical attention not only to what is done but also as to how it is done and at what cost in time, labour and money and also paying attention to the design of the machine and its working processes and not merely to its end product". These authoritative quotations about the scope of the work of the Special Reorganisation Unit and the O & M Division would show that there is much in common between them. As pointed out by a correspondent in the issue of the Institute's Journal for July-September 1958 the problem as to how to integrate the work of the Central O & M Division with that of the Special Reorganisation Unit is worth careful consideration.

VIII

Shri Gorwala in his Report on Public Administration in dealing

[2] *The Organisation of the Government of India*, (Published for the Indian Institute of Public Administration); Bombay, Asia Publishing House, 1958, p. 81.

[3] *Ibid*, pp. 64 and 339.

with financial control in states observed as follows:

> What is really needed in financial matters is control and not interference. What would seem to be happening is exasperating interference in small matters leading to a great deal of waste of time, energy and frustration on the part of the administrative departments, that is, the greater part of government. This must be avoided. It is heartening to note that in the states generally, relations between the administrative departments and finance seem to be much more cordial. This is probably due to the fact that, states secretariats being smaller and housed in one building, contact between the Secretaries is so much greater and any matter tending to become difficult can be discussed straightaway. So too, officers lower down are likely to meet more frequently and matters can be settled fairly easily. Even if the proposal is not sanctioned, since reasonable explanation is generally available, there is no feeling of frustration.

All the same it will be seen from the article "The Problem of Financial Control in the Bombay State" published in *Indian Journal of Public Administration* (Vol. IV, No. 4, October-December 1958, pp. 435-50) that the criticisms that the increase in government activities and expenditure in the state has not been offset by any delegation of financial authority, that the Finance Department should adopt a more constructive, as distinguished from a merely critical, approach to the problems of finance than has been the case in the past and that the traditional approach cannot any longer be defended, apply to the state field also to a large extent. The suggestion in that article regarding the posting of internal Account Officers to all major departments of the secretariat and offices of some of the heads of departments either separately or jointly with another department and for locating officers of the Finance Department in the administrative departments may be compared with the arrangements for internal financial advice in the centre which obviously give a better solution.

The Administrative Reforms Committee set up by the Kerala Government in August 1957 also considered, among other things, "measures calculated to improve administrative efficiency for the coordination of the activities of the different government departments and for the avoidance of overlapping for decentralisation of powers at various levels with a view to expeditious despatch of government business". The recommendations of that committee have already appeared in *Indian Journal of Public Administration* (Vol. IV, No. 3, July-September 1958, pp. 362-67). To facilitate comparisons with the suggestions made by various persons and authorities as detailed in this article some of them are repeated here. It laid down that one of the

guiding principles for administrative reform should be to delegate greater and greater authority to the lower units of administration, consistent, of course, with the necessity for centralisation in matters of broad policy. It also made the following recommendations:

"The budget for each department should show all the expenditure provided on behalf of that department. If a scheme has been included in the budget after the scrutiny of the detailed estimates by Finance then there is no need to seek fresh financial sanction after the budget is passed unless it is proposed to alter the original estimate materially.

"There should be a financial unit under a Financial Assistant or an Adviser, in the office of each important head of the department, who should be held fully responsible for budgeting, expenditure control, internal audit and the scrupulous observance of financial rectitude in that department. The Financial Assistants of all the departments should form a common cadre.

"Interchange of personnel between the Finance and administrative departments may be made from the level of Assistant Secretary and above.

"A non-official Standing Finance Committee may be set up to scrutinise the budget proposals before they are finalised by the Finance Department for presentation to the Legislature.

"Spending departments should prescribe quarterly targets for expenditure to avoid lapse and also heavy rush towards the close of the financial year.

"A unit for economic research whose functions should include a study of the taxation proposals and the impact of the government's socio-economic policies on the country's economy should be set up in the secretariat."

The committee further considered that a minister should permit and encourage the execution of delegated authority by officers without hindrance or interference. It recommended the formation of an O & M Division in the secretariat as part of the Public Department.

* * *

The difficulties, solutions and outstanding matters relating to the problem of financial control over expenditure in the centre have been detailed at some length in this article in the hope that they will be found of help in solving similar problems of financial control over expenditure in the states and will also facilitate a more critical and informed understanding of measures so far taken in the centre. □

Expenditure Control in a Development Administration*

O.K. Ghosh

THE FRENCH intellectuals, who are supposed to be a very clear-headed lot, generally begin their books and articles with a paragraph on 'generalities'. I am following their example in the hope that a preliminary discussion of the basic issues involved will be of help in coming to definite, logical conclusions.

There is no doubt that the subject of expenditure control in a 'Development Administration' requires to be treated separately from that in a 'Law & Order' Administration. The very fact that there is widespread criticism of the system of expenditure control highlights this statement. On the other hand, this widespread criticism should not be overestimated. There are certain people, and specially impatient technocrats, who do not like any sort of financial discipline. There are others who may not like financial discipline for less honest reasons. And this has been so in all civilizations and in all times. Bertrand Russell once wrote about the malevolence of financial officers and how they should not meddle in affairs involving innovation, seeing that they are bound by rules and precedents. The objections generally made by people against financial control are that the advisers:

(*i*) are ignorant of the subject matter in which they presume to give advice, specially in technical matters;
(*ii*) their air of omniscience is irritating and exasperating;
(*iii*) they are full of righteousness and a sense of virtue, as if they are the only honest people in the world;
(*iv*) their insatiable curiosity leads to inordinate delays;
(*v*) they are pettifogging, concentrating on small things when grand dreams are being dreamed and grand things planned; and
(*vi*) they think not in terms of physical resources and skills but money. This is an outdated and obsolete idea.

From all these criticisms, it follows, according to them that the best thing would be to abolish expenditure control altogether! A finance

*From *Indian Journal of Public Administration*, Vol. XII, No. 3, July-September, 1966, pp 504-16.

man is good for budgeting, making payments, costing, accounting, giving various kinds of reports to the management on financial matters, etc., but he should have no say in decision-making.

Let us first see, therefore, whether there is any need for expenditure control. The main problem is that neither resources nor anything else is plentiful in India, like air or water. (Now and then even water is not plentiful in India!) The demands are many and the resources few. Let us make an analogy. A lady in the house of Tata or Birla need not bother about what she spends. But not so with an ordinary housewife. Unfortunately we are, by world standards, in the position of very poor housewives. The intellectual and opinion making classes, however, very often consciously or sub-consciously think of themselves either as Zamindars or as next to the British in the world. Hence, we aspire to the standards of the Cadburys, Rockefellers and Montecatinis without having their wealth. If we do not have their wealth; it follows, as night follows day, that rationing of resources of skills is necessary. As in all economies, except the most primitive, the index of wealth is money, rationing of monetary resources is equivalent to the rationing of physical resources and of skills and is inevitable in a backward society (not to mince matters and use the term—'under-developed society'). And, somewhere, every control has, unfortunately, to begin with saving candle-sticks. As Gladstone said in 1877, at the time of the appointment of the Hon. F.A. Stanley (later sixteenth Earl of Derby) as Financial Secretary to the Treasury:

> Stanley is clever, but can an heir to the Earldom of Derby descend to the saving of candle ends, which is very much the measure of a good Secretary to the Treasury?[1].

If some critic says that I am being pseudo-British myself, consciously or unconsciously, by quoting the above statement, I can counter this with a Bengali proverb, the effect of which is the same. The proverb runs as follows:

Je jan divase maner harashe
jalae momer bati,
Ashu grihe tar dekhibe na ar,
nisheethe pradeep bati.

This means: In the house of the person who freely has the candles lit during day time, we will soon see that at night there is no light at all.

If the saving of candle-sticks is then necessary, then the question

[1]Sir Edward Bridges, *Treasury Control*, London, University of London, 1950, p. 6.

arises who should do it? Falling back to the housewife analogy again, should it be done by the housewife or should someone from outside constantly remind her of it? It is clear that it is for the housewife herself to save candle-sticks and here the critics of external expenditure control have secured a point, but only at the cost of conceding that expenditure control is necessary. Otherwise, there will be a run-away excess of expenditure over income—what the Americans call 'cost overruns'—of the type which disgraced the later years of the Chiang Kai Shek regime in China. To give an example more ponderous than that of candle-sticks, a building can cost Rs. 30 lakhs or Rs. 40 lakhs. The question is, do we have enough money to spend Rs. 40 lakhs? If we do, no or very little expenditure control is necessary. If we do not, we will unfortunately have to follow financial discipline.

Those who are still dubious about expenditure control will say that in the private sector there is not separate expenditure control. The management do their own expenditure control. This is markedly different from the public sector and government departments where there are separate financial controllers and advisers. The analogy is not quite apt. In the private sector the market mechanism is at work and the criterion is simple—what increases profit? It is true that in the private sector also other considerations, like those of family, might count; but, by and large, these are subordinated to the profit criterion. Many products of public sector concerns have certain prices which can only be called 'social prices'. They are sold, for instance, fertilizers, at a price which is thought to be beneficial to the community, and not with the profit idea in mind. Similarly, as regards hospitals, schools, etc., which are also part of 'development' expenditure. The question of the criterion of profitability cannot apply here. It will be seen that in many items of what is known as the infrastructure of an economy, the profit factor will not be the only factor. Sometimes it may be a small factor. This applies to the superstructure as well. For instance, how much are we to spend on cultural relations with other countries and cultural exchanges? Should money and profitability be the only concern? I understand that even now the old French tradition of having 20 per cent of cost of public buildings set apart for beautification persists. The point which I am trying to make is that if the profit motive is not the only guiding criterion, then the private sector analogy cannot apply. Are no financial standards to be followed, then? The answer obviously is that unless a country or society is fantastically rich, financial standards have to apply. And it is here mainly that the financial advisers and controllers come in.

A general point as regards expenditure control in the private sector and in the public sector is that, when all is said and done, people in the public sector are not people in the private sector. The money is

not their own, even though some people might behave as if it is. Since the government is always there, behind somewhere, like a granny, this has an inevitable impact on the psychology. Hence, having no sort of expenditure control or leaving it entirely to the good sense of the people in charge would be a very imprudent way of doing things in one of the poorest societies in the world. For, if the technocrat is enthusiastic, he will tend to go in for expenditure beyond the dictates of prudence; and if he is prudent, and not enthusiastic, he may not be a technocrat who can inspire others. Thus, the necessity of two people, a spender and another who exercises prudence, a sort of wife-husband team.

There is another aspect, the most important aspect of the matter. This is that of public accountability. Ours is a politically democratic country. We are answerable to the Legislatures. Our system is based on British institutes, and not on those of America, formed under Montesquieu's ideas of the separation of the Legislative, the Executive and the judiciary. The legislatures have full control over the Executive and expenditures have to be justified, in the last analysis, to the legislatures. Someone, whether belonging outside or inside the agency spending money has to do this. And this someone cannot be a mere post office. Sooner or later, the question of control would come.

Having thus dwelt a little generalities, we may turn to see what the position has been in India in the past and what the position is in USA and in USSR. Did they or do they have any system of expenditure control?

POSITION IN ANCIENT INDIA

Let me give some extracts, in translation, from Kautilya's *Artha Shastra*. According to most scholars this portrays the system as obtaining under the Mauryas. It is pertinent to seek Maurya precedents because, as in present day India, they were also engaged in vast development works, specially of land clearing, of amalgamating tribal peoples in a general society, and of founding new villages, as brought out by Shri D.D. Kaushambi in his book *The Culture and Civilization of Ancient India in Historical Outline*. *Book 1*, Ch. XV. 28 "Means to carry out works, command of plenty of men and wealth, allotment of time and place, remedies against dangers, and final success are the five constituents of every council deliberation" (The Business of Council Meeting). *Book 2,* Ch. VI. 61 Collector General—*Samahartr* (Duties). "Preparation of plans for profitable works, balance of fines due, demand for arrears of revenue kept in abeyance, or examination of accounts".

"Thus a wise collector-general shall conduct the work of revenue

collection, increasing the income and decreasing the expenditure."

Book 2, ch. IX. 69 "Hence the chief officer of each department *adhikarana*) shall thoroughly scrutinise the real amount of the work done, the receipts realised from and the expenditure incurred in that departmental work, both in detail and in the aggregate. He shall also check (*pratishedhant*) prodigal, spendthrift and niggardly persons."*

POSITION IN MUSLIM INDIA

Let us take Akbar's India as an illustration. Under Akbar's administration, finance was under the *Wazir* or *Diwan*, who worked under the *Wakil* or Principal Executive Officer. As in Maurya times, revenue, accounts and expenditure were concentrated more or less in one department. The provincial administrations also had their *Diwans*. Military expenditure had a separate controller—the *Mir Bakshi* and the Royal household expenditure had another controller, the *Khan-i-Saman*. A very high official was the *Mustaufi* or Auditor General showing the importance the Mughals attached to financial administration.

It might be said that in spite of all these precautions both in Maurya as well as Muslim India, there is evidence of a lot of corruption. The answer to this is that if these checks were not there, things would have been much worse!

POSITION IN UK

In UK, and in Commonwealth countries in general, practically the same methods of expenditure control are followed. The central point in this control system in Britain is its famous Treasury. The British Treasury is descended from the medieval Exchequer.[2] Its powers increased bit by bit until, in 1899, statutory powers were given to the Treasury over most new ministries, as follows:

> 'The Minister may appoint such secretaries, officers and servants as he may with the consent of the Treasury determine'.[3] Treasury control is exercised as follows:
>
> (*a*) control over estimates at the time of the preparation of the budget;

*Tasmadasya yo yasminnadhi,
Karane sasansatah sa tasya
Karmano yathathyamayavyayayan
cha vyasa-masabhyamachakshita.

[2]Samuel H. Beer, *Treasury Control*, Oxford, The Clarendon Press, 1956, p. 1.

[3]Quoted in Bosworth Monck, *How the Civil Service Works*, London, Phoenix House Ltd., 1952, p. 65.

(*b*) necessity for Treasury authority before any new service or branch of expenditure can be started and for any increase in staff or pay.[4]

At the time of the framing of budget estimates, the Treasury check is very broad.[5] Hence, detailed control by the Treasury, before any money is actually spent, is necessary. Before 1921 the Accounting Officer in each Department, who was responsible for financial questions was usually a Finance Officer. These Finance Officers were regarded in the nature of "outposts of the Treasury".[6] In 1921 the position changed. The Permanent Secretary of the Department became the Accounting Officer, but he retained a Principal Finance Officer on his staff. Sir Edward Bridges says that when this reform was introduced it was for several years the subject of some controversy.[7]

"The essence of the arrangement is that it ensures that responsibility for policy, and for financial consequences of that policy, go hand in hand; and that finance is not something troublesome and inconvenient, no doubt, but which need not be thought about until after policy has been settled."[8]

This reform in the British system is linked with the name of the then Permanent Secretary to the Treasury, Sir Warren Fisher, who said that "the Heads of Departments should work together as a team in the pursuit of economy in every branch and every detail of the public service" and that "Treasury Officers should not assume for themselves a peculiar righteousness and a corresponding omniscience.[9]

The Treasury has such prestige in Britain that at one time, in the days of the powerful Lord Palmerston, it stopped a small war by refusing to agree to the required expenditure.[10]

For Parliamentary checks on budget estimates there are what are known as Select Committees on Estimates. In the earlier days, these Estimates Committees apparently did not live up to expectations, Sir Gilbert Campion expressed the opinion that they did not have sufficient knowledge and that the Treasury could not help them much as the budget estimates reflected the Treasury's own ideas on various mattters.[11] Later on, however, there was some streamlining in the work of the Estimates Committees. Each such Committee was broken up

[4]Sir Edward Bridges, *op. cit..*, p. 7.

[5]Samuel H. Beer, *op. cit.* p. 25, *et. seq.*

[6]Sir Edward Bridges. *op. cit.*, p. 10.

[7]Sir Edward Bridges, *op. cit.*, p. 11.

[8]*Ibid.*, p. 11.

[9]*Ibid.*, p. 11.

[10]C.K. Webster, *The Foreign Policy of Palmerston*, London, 1951, pp. 388-389.

[11]Basil Chubb, *The Control of Public Expenditure*, Clarendon Press, Oxford, 1952, p. 208.

into three or four sub-committees, meeting once or twice a week. It was found that, other factors being equal, the sub-committees covered three or four times as much ground as a single group body and probably more.[12] Sir John Wardlaw Milne, MP, said about these sub-committees that "all the documents which were coming before the Sub-Committee on any day had been read by each Member of that Sub-Committee."[13] He contrasted this with his experience in the Estimates Committee, where "very few Members knew anything about what was going to happen on that particular day at all".[14]

POSITION IN USA

In the American governmental pattern there is no system of prior financial approval to proposals.[15] The Congress and the State Legislatures pass laws and vote funds. The relevant Appropriation Acts are very specific. Once sums are voted, money is spent according to these detailed appropriations by the head of the Department or Bureau concerned. He has no external financial and accounting matters. He might, if he so chooses, delegate this watch-dog function to a subordinate of his, but that is entirely his own concern. He is not required to do so. Wherever I explained the Indian (which is the UK system) to American officials in various Departments and Bureaux in USA, they held up their hands in horror. It was impossible for them to conceive how work could proceed with a person from outside the Department and his myrmidons constantly looking over the shoulder and nagging. This seems to show that human nature is malleable enough for many system (if not any system !) to be workable, provided they have had the sanction of time.

In the American system, however, there is constant review by 'budget examiners'. There is a Bureau of the Budget, directly under the control of the President, in the American Federal Government. Similarly, for state governments, the officials of the Bureau of the Budget sit with the officials of different Departments and Bureaux throughout the year and the final budget estimates are prepared only with their concurrence and approval. In other words, the budget examiners check that the estimates are supported by adequate blueprints and detailed plans of action, all at one stage. There is no splitting up of the check into two stages as in the British system. Once this is done, the proposals go to the Legislatures, where they are again

[12]Basil Chubb, *op. cit*,. p., 217.
[13]*Ibid*., p. 221.
[14]*Ibid*., p. 221.
[15]Samuel H. Beer, *op. cit*., p. 25.

scrutinized by aggressive Congressional or state legislative committee.[16] As the appropriations are in great detail, and as there has been thorough check of the estimates beforehand both by the budget examiners and by legislators who have adequate expert staff, further check by men of a finance department, a department external to the spending departments, is not necessary.

POSITION IN USSR

There is very little information about the methods of financial control in USSR. It appears that in factories and production units at any rate, what is known as 'ediny nachaly' or unified control, is favoured. Thus, for instance, in Kolkhoz organizations, the Chairman of the administration is responsible for everything. But he has by his side a Chief Book-Keeper. The Chief Book-Keeper looks after, not only accounts and finances, but is also supposed to have a say in the control of work achievement. He supplies the State Bank with progress reports, on which the amounts of quarterly cash advances are determined. He also plays the leading role in the organization of "socialist competition."[17]

It appears from an indirect reference in a well-known Soviet text-book that there is internal financial control.[18] It also appears that there are 'budgetary commissions' in the Soviet system.[19] Also, that the budgets of local bodies are scrutinized by workers' deputies.[20] These budgetary commissions and other supervisory bodies of legislators must be functioning more or less in the same manner as the Estimates Committees and their Sub-Committees in UK, but precise information is lacking.

HEADS OF STUDIES OF PROBLEMS AS REGARDS THE POSITION IN INDIA TODAY

It will thus be seen that in all the cases that we have looked into there has been, or is, expenditure control over governmental transactions. This control is also—at any rate in theory—detailed. In the British system, which we have inherited, the control is in two stages and the detailed check comes later. At first this was through external financial advisers. Now it is through internal managers.

[16]Samuel H. Beer, *op. cit.*, p. 63.

[17] Alexander Vucinich, *Soviet Economic Institutions*, Hoover Institute Studies, Stanford University Press, 1952, p. 115.

[18]N.N. Rovinskii, *Financovaya Systema USSR*, Moscow, 1952, p. 153.

[19]*Ibid.*, p. 147.

[20]*Ibid.*, p. 148.

We might consider the subject, so far as we are concerned now, under the following heads :

(*a*) Legislative Control
(*b*) Strategy-Planning Methods
(*c*) Operational Methods
(*d*) Operational Personnel.

Legislative Council

It has been seen, in considering the position in UK, that sub-committees do work in a much more business like manner than the full committees. As sub-committees specialize, their comments would also be more helpful and realistic than those of non-specialist committees. In India, various Estimates Committees of the Legislature go into projected expenditure. However, the device of the sub-committee does not appear to be very widely used. This device, with some knowledgeable officers attached to the Legislatures serving as Secretaries, Deputy Secretaries, etc., to the Estimates Committee, should be very useful.

Strategy-Planning Methods

The complaint has been, and is, that our strategy is almost entirely financial and does not take into account physical possibilities. It is very necessary to have a good strategy as operational tactics by themselves would achieve very little if the strategy is not correct. Readers will no doubt recall what Babar said about Ibrahim Lodhi after the First Battle of Panipat, that he was "careless in his methods, who marched without order, halted or retired without method and engaged without foresight". It is thus seen that it is not enough to be active, energetic and dream big things all the time. One has to think and plan as well as act. Unfortunately, amongst our directing classes, there seems to be some sort of polarization between the thinking types and the doing types. And the criticism can perhaps be made that the present structure does not encourage, no matter what may be the intention, of people both thinking and acting. So far as planning goes, one of the essentialities would be to plan from the physical point of view. Thus, we might set out to have, say, so many houses over a five-year period. Now in working out the projects, we will have to work out how much cement we need. Other projects will also work out how much cement *they* need. There would then have to be a 'balance sheet' about cement—the availabilities as well as the requirements. If the requirements are much more than the availabilities, then priorities will have to be given and the projects refashioned accordingly. Thus the project for building houses will also be altered. Similarly, for other critical raw materials, *i.e.*, things in short supply. Each will have to have its own

'balance sheet' and by constant changing and chopping realistic plans in terms of physical quantities as well as skills, etc., can be drawn up. These can then be converted into money values. This is only given by way of a very general idea. There are plenty of factors to make such plans go awry. However, the point is that planning has to start sufficiently early, that physical planning, in the first instance, is necessary, and that monetary planning comes afterwards. How exactly the details are worked out is a separate matter.

Operational Tactics

(*a*) The first suggestion which I would make is that in a developing economy there is great need for 'involvement' even on the part of financial officers and advisers. The only way that this is possible is by making them financial managers. This implies that they will have specific financial powers delegated to them and will look after the day-to-day operation of finances in the organization or department in which they work. They will be under the control of the chief executive of the organization of the secretary of the department. But although they will be 'involved' they will still have to hold a brief for the finance ministry or the finance department of a state. As such if there is any difference between their views and the views of the superiors, there should be a mechanism whereby both are placed before the minister or top man concerned. These people will have the right of having a final say. But the difference of opinion should be placed before either the Finance Minister or the board, as the case may be. Such a system operates in the Indian Railways, and the Indian Railways have been working well, by all counts. To ensure a proper working of this system, certain changes as regards the organization of operating personnel is necessary and this is dealt with below. It is my belief that the change from the external or internal adviser system to the internal manager system will go a long way in removing the hostility to finance personnel on the part of the administrators, and very much more so on the part of technicians.

(*b*) The financial managers, in the various grades, should be seconded to the organization or the department concerned for fairly long periods. In pre-1947 days senior officers used to work as under-studies for about three to six months before they actually took charge. I think it was false economy and bad from the efficiency point of view to have discontinued that practice. A long enough period for questioning and learning would nullify the charge of ignorance. For instance, under present day conditions, if a person joins as a finance officer in charge of matters dealing with, say, oil, it is quite possible that he may not have the chance of seeing an oil rig during the whole course of his tenure. This is because he will always be under a barrage of papers and full of

meetings. If, however, there is a 3-6 month period of study and learning, along with work, he will necessarily have to do a lot of studying about different branches of oil exploration, drilling, etc. It could be seen that he gets this training. Now this training would be well worthwhile only if the financial managers, in various grades, stay with the organization concerned for fairly long periods. In India, the seconding of officers to various departments and organizations is generally not for a very long period and transfers are fairly frequent. Sometimes such transfers take place because of the officer's prospects. Where this is concerned, naturally the officer should, in fairness, be transferred. But, otherwise, fairly long tenures should be the rule. A tenure of at least 5 years for financial managers, in various cadres in any organization should, to my mind, be the general rule.

(*c*) Another point in operational-tactics is whether there should be supreme direction of a single person or there should be a collective responsibility method. The modern view seems to be that there should be a committee of management with an administrative man, a technical man and a financial man. Briefs should be prepared on various items and this should be discussed round the table and decisions arrived at. Thereby each will come to know of the viewpoint of the others and soon a collective spirit should develop.

(*d*) The next change I would urge, as regards operational tectics, is of reformation as regards rules. By all complaints it seems that we have too many of them, and that they are too detailed, with different types of commentaries and instructions under the rules. This is not quite peculiar to India. In the United Kingdom, I have seen the Estacode, which is also quite voluminous. Most of the rules which create friction with audit also are financial rules. In one State in which I have served, there was a Financial Hand-book in six fat volumes. On the other hand, I have seen in many agencies and organizations in the United States that all the rules taken together cover barely 40 to 50 pages. This should be the aim, and one should not hesitate in giving lots of discretion to heads of departments and organizations in applying the rules. This will mean some disparity in practice but this cannot be avoided. One will have to weigh the advantages and disadvantages of having detailed rules and uniformity, or some disparity and as few rules as possible and in my judgment we should opt for the latter. This would be a very difficult task indeed. For, if the rules are simplified, many vested interests will have to go, and a good deal of staff may have to be retrenched if they cannot be deployed elsewhere. Before this can be done, the question will arise as to who will change the rules. I have seen in many organizations that officers have been appointed in order to suggest changes in rules but, by and large, the result has not always been as intended. The rules have not been simplified much.

The reason why this has not been so is not far to seek. Many of those who have been appointed to change the rules have been either retired officers or those for whom, temporarily, berths cannot be found. These officers, naturally, have taken their own time in making suggestions. Even if a very sincere officer is appointed, he will meet with such an opposition from vested interests that his efforts will probably bear little fruit. If rules are to be changed, to my mind, this will have to be done from the top One may recall Napolean presiding over the deliberations of his officers and using the red pencil freely. It was thus that the Code Napolean was brought into being. A similar sort of thing will have to be done as regards the rules, if there is any sincere desire to change them. A corollary is that after the promulgation of the new rules, all will have to come under them without any exception. This, however, may not be possible without amending the Constitution. A possible corollary may also be that the revised rules will be the most liberal among those existing.

Operational Personnel

A claim has been made that, specially in development projects, the finance and accounts officers should be Chartered Accountants and Cost Accountants. I think that there are arguments against this also. Government departments and public sector corporations fulfil basically social roles. They exist mainly, where the private sector does not venture, as quick profits are not to be had, or, for some reason or other, cannot come in. As such, the finance officers should be people of broad general education, recruited through competitive examinations, rather than purely accounting technicians. If expenditure control is at all necessary, it should not be left to pure technicians. Of course, over and above the broad academic training, specialized training is necessary. How this can be achieved is dealt with later.

It seems to me that there are great advantages in having a unified General Civil Service. This should include all posts except those of a really technical nature like doctors, engineers, etc. All the people who are 'generalists' should be recruited through a common examination. The initial training should be the same and about 5-6 years should go in executive work. After that, according to aptitudes and options, there should be selection of various lines like finance and accounts, customs, income-tax, etc. For this purpose there should be intensive in-training in the department concerned for a year or so before the person concerned takes over his new duties and responsibilities. In the case of finance and accounts, there should be adequate training in commercial accounting. If the rules are simplified, then this should not take much time, and most of the training would be in commercial accounting, costing, etc. All the various branches of the General Civil

Service should have the same pay scales and job opportunities and again in the highest ranks there should be free transferability. If we have to have a strong mandarinate there is every reason why it should be a unified one with the minimum amount of internal jealousies and friction and with the maximum amount of flexibility and common cementing bonds. So far as the central government goes, there will then be a specialized cadre of finance and accounts officers. If we have to have expenditure control—and everything points to the necessity for such control in a poor state—then to make it effective and to meet also the point of technocrats to the extent that the grievances seem justified, the suggestions made in these paragraphs would seem to me to deserve consideration.

CONCLUSION

Of course, in the last analysis, it is the spirit which counts. In the United Kingdom, for instance, where a spirit of compromise and pragmatism prevails, treasury officials, administrative executive officers and technocrats ultimately come to some sort of understanding by the process of give and take. In India, the educated classes have always put much greater stress on theoretical principles and abstract ideas and people tend to stick unyieldingly to their points unless forced to resile for some reason or other. Hence, it has to be admitted, the British system is not working very well. For, if anybody sees reason and gives in he is generally taken to be soft or weak.

Thus, form is really immaterial. Substance is the main thing. If the spirit of efficiency and economy is there, adequate forms will be designed. If the spirit is not there—and this matter is far bigger than the scope of this article—no amount of formalization and detailed checks and prescriptions will be of much use. □

Financial Discipline for Union and State Governments*

K. Santhanam

SINCE THE economic crisis which was developing during the last four years ended in the devaluation of the rupee at midnight of June 5, 1966, the expression 'financial discipline' has come into vogue. This, of course, implies that the Union and State Governments had failed to exercise discipline in the past. The following paragraph from the Supplement to the Economic Survey placed before Parliament indicates roughly the official view of the nature of discipline that is contemplated. "As already mentioned, positive steps will be neccssary to ensure that the budgetary balance is maintained. It will be necessary to introduce fresh measures of economy in expenditure, improve the performance of our projects so that an adequate increase in output is obtained from investments already made and to undertake fresh investment only to the extent that genuine savings are available to finance them. These measures imply a rigorous discipline on the part of Central and State Governments alike and also a constant watch by the Reserve Bank over the creation of credit by the banking system."

That every year the budget should be balanced is obviously the first step in financial discipline. So far as any particular year is concerned, it is the ways and means deficit that is important. So long as the total of revenue and capital expenditure is balanced by revenues, loans and other capital resources the budget may be said to be balanced. It is the loose attitude towards deficit financing which was taken by the Finance Ministers of the past that has been one of the major causes of inflation. In the First Plan, deficit financing amounted to Rs. 333 crores but as we had a large sterling balance to pay for imports, this did not matter so much. The Second Five Year Plan budgeted for deficit financing of Rs. 1,200 crores and during the last three years of that Plan, the mischief of such deficit planning was partly recognized and an attempt was made to reduce it. Still the total amount of deficit planning amounted to Rs. 950 crores. Unfortunately this lesson was not fully learnt and in the Third Plan, deficit financing of Rs. 550 crores was included among the resources. As a matter of fact, it is estimated

*From *Indian Journal of Public Administration*, Vol. XII, No. 3, July-Sept., 1966, pp. 499-503.

that the actual deficit financing has been greater by about Rs. 200 crores, in spite of a massive effort at financing the additional burdens caused by Chinese and Pakistani aggression by savage taxation. The following account of the budgetary position of the Central and State governments during the year 1965-66 shows how the spirit of extravagance and the habit of indulging in deficit financing, has been almost built into our political system. "The deficits at the Centre was Rs. 144 crores; the deficit of the State Governments, after taking into account substantial sales of Treasury Bills by them, was as much as Rs. 196 crores. If allowance is made for the support given by the Reserve Bank to Government loans, the total deficit financing of Central and State Governments was Rs. 385 crores. The large deficits were incurred although the regulatory duty on imports was continued and additional taxation of Rs. 111 crores was levied during the course of the year both through the regular and supplementary budgets."

In considering budgets over many years, it is not enough if the ways and means position does not show a deficit. It is essential that the revenue and capital budgets should balance separately. There may not be much harm, if the revenue budget shows a surplus, though such surplus always induces a tendency to increase revenue expenditure unnecessarily. On the other hand, it is altogether objectionable that revenue deficits should be made up by capital receipts. A revenue deficit is likely to be a recurring burden and to attempt to meet it by capital receipts year after year will not only mortgage the future by increasing burdens of interest and repayments but will also prevent the economic development of the country by reducing the available capital for large and new investments required.

To a large extent, this principle has been followed by the Government of India. From 1955-56 to the current year, the revenue budget of the Central Government has been showing surpluses. During the Second Plan, it was an average of about Rs. 50 crores. In recent years, this has been much larger, the surplus for 1961-62 being Rs. 125 crores. for 1962-63 Rs. 113 crores, for 1963-64 Rs. 188 crores, for 1964-65 Rs. 274 crores, and for 1965-66 Rs. 282 crores. For the current year, it has been estimated at Rs. 210 crores.

Apparently, this has been a satisfactory performance on the part of the Finance Ministry of the Government of India. Sober reflection shows that the surpluses have not been as real as they appear to be. Since the inauguration of planning, the old practice of debiting unproductive capital expenditure to revenue has been discontinued and expenditure on all items of long term utility have been debited to capital. This is justified by the contention that when buildings for secretariats, colleges and hospitals are put up and roads and bridges built, they yield benefits in future years and it is hard on the people to

try to force them to pay for them out of revenues raised in the years in which the expenditure is incurred. This argument is valid to a certain extent but when such capital expenditure becomes an annual recurring feature and no sinking fund arrangements are made for its amortization, the practice amounts to saving present trouble at the expense of the future. Thus for the year 1964-65, defence capital outlay amounted to Rs. 113 crores, for 1965-66 Rs. 120 crores and the same amount has been budgeted for 1966-67. For public works including roads and schemes of miscellaneous improvements, the capital expenditure was Rs. 84 crores for 1964-65 and 1965-66 and estimate for the current year is Rs. 71 crores indicating that a deliberate effort has been made this year to reduce it. If these two items had been treated as revenue expenditure, it will be seen that the revenue budget of the centre would have merely balanced leaving no surpluses.

Taking the states as a whole, they have been consistently indulging in deficits. For the First Plan, the overall deficit was Rs. 15 crores; it rose to Rs. 64 crores for the second and Rs. 166 crores for the third. For 1966-67, no less than Rs. 84 crores of deficit is estimated. That these deficits should have been incurred in spite of the continuous exhortations of Central Finance Ministers proves that the State Governments have not been amenable to any financial discipline. It cannot be contended that the Central Government have no means to enforce discipline. The bulk of the loans to the States has come from the Government of India. Besides large transfers in the form of shares of taxes and grants given to the States in accordance with the recommendations of the successive Finance Commissions, big amounts of specific grants have been given under Article 282. They have amounted to nearly Rs. 150 crores in the First Plan, Rs. 460 crores in the Second and Rs. 735 crores during the Third Plan. The loans given from the Centre amounted to Rs. 799 crores in the First Plan, Rs. 1,411 crores in the second and Rs. 3,100 crores in the third.

If, as suggested above, the expenditure on unproductive works like roads, offices, educational and medical buildings had been treated as revenue expenditure by the States also, revenue budgets of all the States would have been in continuous heavy deficits. But by means of debiting them to capital expenditure and heavy central subventions, the States, as a whole, have managed to balance their revenue budgets with a surplus of Rs. 21 crores during the Third Plan. But it is necessary that each individual State should balance its budget, as the surplus of any State is not available for meeting the deficit of any other State. Also as has already been remarked, the emergence of a surplus immediately induces new expenditure, while hardly any State with deficit, tried to reduce it by economy or by additional taxation. The deficit States hopefully look forward to the next Finance Commis-

sion whose function has come to be more or less the routine task of helping the States to balance their revenue budgets. Thus Assam had deficits for 1964-65 and just presented a budgetary balance for 1966-67, owing to the fresh subventions of the latest Finance Commission, Jammu and Kashmir incurred deficits of Rs. 2 crores in 1964-65 and Rs. 6 crores in the next two years. Madras, which usually has a financial standard of rectitude, incurred a deficit of nearly Rs. 8 crores in 1965-66. Mysore, Orissa and Rajasthan have been running recurring deficits for the past three years.

Mere balancing of budgets indicates only conformity to formal financial propriety. Real financial discipline requires that non-development expenditure should be kept at the minimum and the taxation resorted to, to cover the deficits should be such, as not to add to the inflationary forces.

It is wrong to think that all taxation is disinflationary. Direct taxes have undoubtedly this effect. But indirect taxes are inflationary to the extent that they can be passed on to the consumer and result in increased prices. There can be no doubt whatsoever that the taxation policy of the Government of India has been a powerful factor in the increase in prices and the grave disequilibrium between internal and international prices which made devaluation imperative, if not inevitable. The tax revenue of the Government of India increased from Rs. 485 crores in 1955-56 to Rs. 2,032 crores in 1965-66. Of this customs increased from Rs. 163 crores to Rs. 526 crores and excise from Rs. 142 crores to Rs. 851 crores. Thus an increase of over Rs. 1,000 crores was levied through these two indirect taxes. The states increased their sales taxes by over Rs. 200 crores. To these must be added an increase of Rs. 200 crores on railway freight and perhaps half the amount on motor freight. In a free economy, where production tends to be in excess of demand, some part of these indirect taxes tend to be met by decreased cost of production or reduced distribution charges. But Indian economy has been strictly controlled and there has been continuous scarcity for every kind of goods. In these circumstances, the indirect taxes automatically entered into costs and prices and constituted powerful inflationary factors.

If all the increased revenue had been devoted to the economic development, there would have been some social compensation. But non-development expenditure has swallowed a major part. Defence expenditure has increased from Rs. 172 crores in 1955-56 to Rs. 768 crores in 1965-66 and Central administrative services from Rs. 34 crores to Rs. 110 crores. The non-development expenditure of the states has gone up by more than Rs. 500 crores.

In the paragraph quoted in the beginning, the lack of proper return from investments has also been mentioned as a matter requiring

financial discipline. All investments of the Central and State Governments can be divided into: (*i*) unproductive capital expenditure which should, under proper accounting, have gone into revenue expenditure, as has already been pointed out, (*ii*) semi-productive investments which are expected to cover their depreciation and interest on capital and yield some net profit but which have not yet done so, and (*iii*) productive investments which yield a net profit. Of the total of Rs. 11,391 crores of investment in the public sector in the three plans, it is doubtful if even a third of them are now productive. In fact, it is only the railways and a few industrial concerns like the Hindustan Machine Tools Ltd. that have yielded a net profit. All other investments have been either unproductive or semi-productive. Successive Finance Commissions have pointed out that the States have abandoned altogether the old criterion of returns from irrigation work and that even electricity and transport undertakings are working at a loss.

Lastly, the Central and State loans are becoming increasingly dependent on support by the Reserve Bank and the scheduled banks. It is admitted that to the extent the Reserve Bank subscribed to these loans, it is deficit financing in another form. I think that the subscriptions by banking concerns to these loans have nearly the same effect. It is open to the scheduled banks to deposit these securities with the Reserve Bank and increase their credit capacity.

It is needless to say that financial discipline only on the part of Union and State Governments is not enough. They are equally necessary on the part of all financial, industrial, commercial and other business undertakings. They have all been indulging in extravagant overheads, perquisites to directors and executives and non-business expenditure including donations to political parties. Planned economy has come to mean partly planned exploitation of the people by all those engaged in the production and distribution of wealth. The natural restraints of a free economy have been suspended but no adequate substitutes based on political or economic conscience or conventions have been substituted.

We may now summarize the conclusions. Effective financial discipline on the part of the Central and State Governments involves: (*i*) balancing the revenue and capital budgets separately, including in the revenue budget recurring items of unproductive capital expenditure, (*ii*) non resort to further indirect taxation, (*iii*) a tight grip over non-development expenditure, (*iv*) strict economy in new development expenditure, (*v*) insistence on all investments in irrigation, power, mining and industry being fully productive, and (*vi*) borrowing only from personal and institutional savings.

It is essential that the annual Economic Survey submitted to Parliament before the budget should cover fully and explicitly all these

points so that the country may know how far financial discipline is being enforced. □

The Finance Commission and Union-State Relations in India*

K. R. Bombwall

AN INNOVATION of far-reaching importance to the working of the Indian federal system is the Finance Commission, "a quasi-arbitral body whose function is to do justice between the Centre and the States."[1], for which provision is made through Article 280 of the Constitution. According to one author, the Finance Commission is "the most important body to regulate, coordinate and integrate the finances of the Government of India and the State Governments".[2] The establishment of this rather unique institution may, indeed, be aptly described as India's original contribution to the theory and practice of federalism since nothing quite like it is to be found in any other federation. It bears some resemblance to the Commonwealth Grants Commission of Australia which was, in fact, frequently referred to in the Constituent Assembly as a model. However, the two Commissions are significantly different from each other both as regards their status and the scope of their competence. The Australian Grants Commission was created, in 1933, under the unprecedented stresses and strains of the great depression, by the Commonwealth Government acting in its executive capacity. It has, accordingly, no constitutional basis. The Indian Finance Commission, on the contrary, is the creation of the Constitution. Besides, the functions entrusted to the Australian Commission are much more limited than those constitutionally assigned to its Indian counterpart. The only regular function discharged by the Australian Commission is to determine the quantum of special federal grants to the three 'claimant' states, *viz.*, Western Australia, Tasmania and South Australia. On occasions, the Commission has also recommended additional payments to these States under Section 6 of

*From *Indian Journal of Public Administration*, Vol. X, No. 2, April-June, 1964, pp. 278-90.

[1]B.N. Rao., *Indian Constitution in the Making*, Madras, Orient Longmans, 1960, pp. 384-85. Dr. Ambedkar appears to have conceived of the role of the Finance Commission in almost precisely the same terms, *viz.*, to do justice between province and province and between the Centre and the provinces, Constituent Assembly Debates, IX, p. 260.

[2]B.R. Misra, *Economic Aspects of the Indian Constitution*, Calcutta, Orient Longmans, 1958, p. 90.

the Uniform Tax Act, but these payments may justly be regarded as part of the special grants procedure and they do not add to the Commission's competence. As H.P. Brown put it some years ago, no attempt has been made to seek a recommendation from the Commission on any grant other than the special grant and the grant under Section 6 of the Uniform Tax Legislation.[3] The functions of the Indian Finance Commission, as we shall see, have a much greater impact on the Union-State financial relations. The Canadian Royal Commission on Dominion-Provincial Relations (1940) recommended the establishment of a Finance Commission to advise on the adjustment and regulation of financial relations between the Dominion and the provinces of Canada, but the recommendation was not implemented.

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Despite the elaborate and detailed provisions for the division of financial resources between the Union and the States laid down in the Indian Constitution of India, the framers realized that no distribution, no matter how carefully made, can be satisfactory for all times and under all circumstances and that the adjustment of federal-state financial relations is a recurring problem. The allocation to the units of a Federation sources of revenue commensurate with their functions is always a difficult problem; and it becomes all the more difficult in a developing economy such as that of India particularly in view of the fact that the development of social services is primarily the responsibility of the States. The constitution-makers, accordingly, took into account the possibility of the States lacking adequate finances to cope effectively with their responsibilities and laid down provisions for the devolution of revenues through the transfer of a part of the proceeds of certain Union taxes to the States and through Union grants-in-aid of the revenues of the States. The constitution provides for obligatory as well as permissive sharing of Union revenues by the States. In order to ensure that this form of Union assistance to the States does not lead to the erosion of the States' autonomy, the constitution has provided that the devolution of revenues and grants-in-aid (with the exception of grants made under Article 282 which are of a discretionary character and are made by the Union Government in consultation with the Planning Commission) shall be made on the basis of the recommendations of an independent agency. This agency is the Finance Commission.

The President of India is required under Article 280 of the Constitution to set up, within two years from the commencement of the

[3]H.P. Brown, "Some Aspects of Federal State Financial Relations" in *Federalism: An Australian Jubilee Study*, ed. Geoffrey Sawar, Melbourne, F.W. Cheshire, 1952, p. 52.

Constitution and thereafter every five years or earlier, a Finance Commission consisting of a chairman and four members. According to the qualifications laid down in the Finance Commission Act of 1951 (amended in 1955) the chairman of the Finance Commission must be a person who has had experience of public affairs and its members should be persons who: (*a*) are, or have been, or are qualified to be, appointed as judges of a High Court; or (*b*) have special knowledge of the finances and accounts of the government; (*c*) have had wide experience in financial matters and in administration; or (*d*) have special knowledge of economics. Article 280(3) of the Constitution lays down the functions of the Finance Commission. At present the commission is required to make recommendations to the President as to: (*a*) the distribution between the Union and the States of the net proceeds of taxes which are or may be shared between them[4] and the allocation between the States of the respective shares of such proceeds; (*b*) the principles which should govern grants-in-aid of the revenues of the States out of the Consolidated Fund of India;[5] and (*c*) any other matter referred to the Commission by the President in the interests of sound finance. The Finance Commission has the status of a Civil Court and it determines its own procedure. The three Finance Commissions so far constituted[6] have followed the practice of visiting the States, holding consultations with ministers and senior officials of the Union and State Governments and members and officials of the Planning Commission and receiving memoranda and oral evidence from individuals and representatives of interested organizations before formulating their recommendations to the President of India.

The Finance Commission is an advisory body and, as a matter of strict law, the President is not bound to act in accordance with its recommendations. It was, however, recognized by the framers of

[4]Under Article 270 of the Constitution, the proceeds of income-tax, levied and collected by the Union Government, have to be compulsorily shared with the States. Article 272 contains an enabling provision under which the proceeds of Union excise duties, except those on medicinal and toilet preparations, may be divided between the Union and the States. Article 269 gives a list of taxes which can be levied and collected by the Union but are assigned to the States. The Finance Commission determines the manner in which the proceeds of these taxes should be distributed among the States. So far only two of these taxes, *viz.*, estate duty in respect of property other than agricultural land and the tax on railway passenger fares have been imposed. The latter was abolished in 1961, but the Union Government decided to give the States an *ad hoc* grant of Rs. 12.5 crores per year for five years (1961-66) to be distributed among them on the recommendations of the Finance Commission.

[5]These grants are made under Article 275 of the Constitution. The Finance Commission is not consulted in regard to the grants made under Article 282.

[6]By the Presidential Order, dated May 5, 1964, the Fourth Finance Commission has since been constituted under the Chairmanship of Dr. P.V. Rajamannar, Retired Chief Justice of Madras High Court.

the Constitution that the creation of such an institution in a federal set-up would have little meaning if its recommendations were not to be accepted by the President except, of course, where considerations of overriding importance jutified deviation therefrom. Thus, Pandit Hirday Nath Kunzru, a member of the Constituent Assembly, expressed the hope "that a convention will grow up that the Government should normally, that is except in emergencies, accept the recommendations of the Commission".[7] Speaking, in 1953, of the matters on which the Finance Commission has to make recommendation, Sir Ivor Jennings took a rather sceptical view of the Union Government attitude towards the recommendations of the Commission. "These matters", he observed, "are not decided by Commissions . . . The problem is almost invariably one of votes. Commissions propose, but politicians dispose and politicians depend on votes."[8] Facts, however, have proved Sir Ivor to be a poor prophet. The politicians of New Delhi have, indeed, treated the recommendations of the Finance Commission with utmost respect.

Of the various recommendations made by the three Finance Commissions only two have been rejected by the President but, in doing so, elaborate and cogent arguments have been advanced by the Government of India in the memoranda which were placed before Parliament along with the commission reports concerned. One of the matters on which the Union Government found it impossible to agree with the second Finance Commission concerned the latter's recommendations regarding the consolidation of Union loans to the States and the revision of interest rates on these loans. The government did, however, make important modifications on interest rates in the light of the Commission's recommendations and, as a result, the object for which the Finance Commission had made its recommendations was more or less completely achieved although the recommendations themselves were not accepted. The net result of the changes introduced by the Union Government was "to reduce by Rs. 4 crores per annum (as against Rs. 5 crores estimated by the Finance Commission) the interest burden on the States on account of loans taken between

[7]It may be noted, however, that Pandit Kunzru was in favour of limiting the role of the Finance Commission to making recommendations in respect of Union grants-in-aid of the revenues of the States. *Constituent Assembly Debates*, IX, p. 258. But Dr. Ambedkar, who defended the more extensive competence envisaged for the Commission under the Constitution, also held that "in the action to be taken by the President, he should be guided by the recommendations of the Fiscal Commission and should not act arbitrarily". *Ibid.*, IX, p. 261. B.N. Rau was equally emphatic in his view that, except in case of patent error, "no Ministry should advise the President to depart from the recommendations of the Commission", *op. cit.*, p. 384.

[8]Sir Ivor Jennings, *Some Characteristics of the Indian Constitution*, Madras, Geoffrey Cumberlege, 1953, pp. 72-73.

August 15, 1947 and March 31, 1958"[9] Similarly, the Union Government did not accept the majority recommendation of the third Finance Commission in favour of grants to the States with a view to covering 75 per cent of the revenue component of State Plans. The government was, apparently, influenced by the strong case made out against the proposal by Member-Secretary Shri Kamat in his minute of dissent and came to conclusion that "there will be no real advantage to the States in receiving assistance towards the Plans partly by way of statutory grants-in-aid on the basis of the Finance Commission's recommendations and partly on the basis of the annual reviews made by the Planning Commission". It may be added that despite Shri Kamat's dissent, the Union Government accepted the third Finance Commission's majority recommendation in respect of a special earmarked grant to certain States for the improvement of road communications. In fact, Union Government tends to give a close and careful consideration even to the general observations which the Finance Commission may deem it necessary to make in its report even if they do not arise out of its terms of reference.

As regards implementation, the Finance Commission's recommendations fall into three categories: those to be implemented by an order of the President, those to be implemented by executive orders and those to be implemented by law of Parliament. Thus, the recommendations of the third Finance Commission under Article 270 (regarding allocation of income-tax) and under Article 275 (1) (regarding grants-in-aid of the revenues of the States) fell under the first category and necessary orders for their implementation were passed by the President on March 19, 1962. The Commission's recommendations in respect of the distribution of the *ad hoc* grant to the States in lieu of their shares of the tax on railway fares is being implemented by executive orders. Finally, the recommendations relating to the distribution of Union excise duties (including the additional duties) and the estate duty on property other than agricultural land belong to the third category and were implemented by parliament legislation, namely, the Union Duties of Excise (Distribution) Act, 1962, the Additional Duties of Excise (Goods of Special Importance) Act, 1962 and the Estate Duty (Distribution) Act, 1962.

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The three Finance Commissions so far constituted submitted their reports to the President in 1952, 1957 and 1961 respectively. As a

[9] Reserve Bank of India, *Report on Currency and Finance for the Year 1957-58*, Bombay, 1958, p. 91.

result of the recommendations of the commission, the States' share of the proceeds of income-tax has been steadily increasing. From 50 per cent before the appointment of the first Finance Commission, it has been raised progressively to $66\frac{2}{3}$ per cent at present.[10] There has been an even more impressive rise in the share of the proceeds of Union excise duties distributed among the States. No such distribution was made before 1952. The first Finance Commission 'broke new ground' by recommending that 40 per cent of the net proceeds of Union excise duties on three commodities (tobacco, matches and vegetable products) should be distributed among the States. The second Finance Commission added five more commodities, namely, sugar, tea, coffee, paper and vegetable, non-essential oils to those recommended by the first Commission, at the same time reducing the States' share of the net proceeds of the duty on all the eight commodities to 25 per cent. The third Finance Commission expressed itself in favour of "participation by the States, by convention, in the proceeds of all Union excises". Actually, it raised the number of commodities the duty whereon is to be shared with the States to 35, fixing 20 per cent of the net proceeds as the share of the States. The Union excise duty on motor spirit was excluded from this computation, but the Commission recommended that a sum of Rs. 9 crores, being approximately 20 per cent of the annual yield of this duty, should be utilized in each of the four years (1962-66) as a special purpose grant to certain States for the improvement of communications.[11]

On the basis of a decision of the National Development Council, the Government of India decided in 1957, to impose an additional excise duty on mill-made textiles, sugar and tobacco including manufactured tobacco, in place of the sales tax levied by the States on the condition that the income derived by each State from its sales tax on these articles should be guaranteed to it. The second Finance Commission fixed the annual amount to be guaranteed to the States as a whole at Rs. 32.5 crores. The second and the third Finance Commissions recommended, further, that the surplus yield of the additional excise duties (after payment of the guaranteed amount) should also be distributed among the States and laid down the ratios in which this should be done.

The recommendations of the successive Finance Commissions

[10]The Third Finance Commission which recommended the increase of the share of States to 66-2/3 per cent was influenced mainly by the fact that the amendment of the Income Tax Act in 1959, whereby the tax paid by companies was excluded from 'income-tax', substantially reduced the 'divisible pool' available for distribution among the states. India, *Third Finance Commission Report, 1961*, para. 28, p. 16.

[11]*Ibid.*, para. 44, p. 21.

have also resulted in a progressive increase in the amount of Union grants to the States under Article 275 of the Constitution. Before 1952, grants analogous to those since given under this Article played a negligible part in the assistance received by the provinces from the Central Government. The first Finance Commission recommended the payment of a little over Rs. 5 crores a year as grants-in-aid of the revenues of the States. The second Finance Commission raised the amount to Rs. 37 crores a year. Under the recommendations of the third Finance Commission, the States will receive over Rs. 52 crores annually as Union grants.

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The above appraisal of the principal recommendations of the three Finance Commissions shows clearly that the Finance Commission has taken due note of the growing inadequacy of the resources of the States, particularly in relation to planning, and their increasing dependence on the Centre for financial assistance. In other federations, financial dependence of constituent units on the Centre has invariably led to the dilution of their autonomy. The Indian Constitution has, as we have noted above, sought to prevent such a development in India, at least partially, by providing for periodic adjustment of the Union-State financial relations through the instrumentality of the Finance Commission. On the recommendations of the Finance Commissions, the quantum of Central assistance to the States has steadily increased. Thus, the first Finance Commission provided for Central assistance to the States—taking into account both the devolution of revenues and the grants under Article 275 recommended by it—of the order of Rs. 93[12] crores a year. The second Finance Commission raised it to Rs. 140 crores per year,[13] excluding the proceeds of the tax on railway fares amounting to Rs. 15 crores a year. The recommendations of the third Finance Commission brought an additional payment of the order of Rs. 35 crores to the States during 1962-63, and, as a result of the increase in the States' share and the widening of the number of shareable excises, the States' share in the coming years will be much larger.[14] The observation "the present Finance Commission have shown themselves more keenly aware of the problems of State finances as a whole and have been more considerate towards their needs than any body entrusted with similar tasks in the past"[15] was made in

[12]Reserve Bank of India, *op. cit.*, p. 81.

[13]*Ibid.*

[14]Reserve Bank of India, *Report on Currency and Finance for the Year 1961-62*, Bombay, 1962, p. 123. It may be pointed out here that these amounts do not include the grants made to the States under Article 282 of the Constitution.

[15]*Indian Finance* (Calcutta), Vol. LX, No. 20, November 23, 1957, p. 970.

reference to the second Finance Commission but is equally true of the third.

The important thing to note here is that financial assistance, whether by way of devolution or grants, which the States receive on the basis of the recommendations of the Finance Commission is of a statutory character and does not involve Central control over its utilization. Accordingly, it does not affect the autonomy of the States. It may be stressed that Central grants to the States under Article 275 of the Constitution are, by and large, united[16] and unconditional and the States are free to utilize them for any purpose they deem necessary. Grants given to the States under Article 282, on the other hand, have various strings attached to them. Not only are they earmarked for specified purposes, they empower Central authorities to examine and approve State schemes in relation to which such grants are offered and to supervise their proper utilization. Above all, they can be used by the Centre to orient State fiscal policies to national purposes through the device of matching grants. Obviously, therefore, the Finance Commission has become a vital part of the machinery of the Indian federal system and its recommendations have tended to bolster up the position of the States by strengthening their finances without subjecting them to Central contro . It must, however. be conceded that the Finance Commission can offer the states only partial protection against Central encroachment in their sphere of autonomy. A large part of Central assistance in relation to the Plans comes to the States in the form of loans and grants under Article 282 of the Constitution. The so-called 'Plan grants', which the States cannot refuse unless they are prepared to forego the benefits of development, make the States vulnerable to Central control.[17]

While its basic approach has been that "the prosperity of the States must rest on the solid foundation of a reasonably strong and financially stable Centre",[18] the Finance Commission has shown a strong awareness of the growing needs of the States "in fulfilling a complementary role in the development of national economy and in the provision of a

[16]The only instances of special-purpose grants recommended by the Finance Commission are the grants for expanding primary education and for improving communications recommended respectively by the first and third Finance Commissions.

[17]According to Shri K. Santhanam, Article 282 was put into the Constitution "as a residuary or reserve Article to enable the Union to deal with unforeseen contingencies" and that it was not intended as "a major provision for making adjustments between the Union and the States". With the advent of national planning, however, the provision has become "a crucial Article for the Plan".

[18]K. Santhanam, *Union-State Relations in India*, Bombay, Asia Publishing House, 1959, pp. 40-41. India, *First Finance Commission Report, 1952*, p. 7.

higher level of social services."[19] The Commission has also recognized the inadequacy of the resources of the States and their increasing dependence on the Centre. Of course, the Commission has repeatedly pointed out the fact that the financial weakness of the States is due, in part at least, to "inadequate expenditure control" and "inadequate mobilization of available resources"; in particular, it has noted that the States "are tending to develop an allergy to tap resources in the rural sector".[20] All the same, the Commission has expressed the view that the insufficiency of the States' resources "is attributable mainly to the planning process and that it may become more pronounced with the completion of each successive Plan for some years to come".[21] That the assistance given by the Centre to the States through Plan grants under Article 282 of the Constitution is bound to cause inroads on the autonomy of the States is, as we have seen, fully recognized by the Finance Commission. Taking note of the complaint made by the States against a "perceptible trend of centralization of resources in addition to centralization of certain State functions",[22] the third Finance Commission has observed: "While we appreciate that in a planned economy a measure of centralization, and even regimentation is inevitable, it is no less necessary that the States should not feel that their autonomy is being frustrated".[23] It is in the light of this solicitude for State autonomy that the implied criticism of the dual system of Central grants to the States (the general-purpose grants made under Article 275 of the Constitution on the recommendation of the Finance Commission and the tied and conditional Plan grants under Article 282 made without reference to it) in the report of the third Finance Commission assumes importance. It is in regard to the discretionary grants under Article 282 that complaints of centralization are most frequently made. These grants, in fact, account for a substantial part of the total Central assistance to the States. While they formed 48.7 per cent of the aggregate Central assistance to the States in the year 1951-52, they assumed the proportions of 80.2 per cent in the budget year 1961-62.[24]

Evidently, it is with a view to safeguarding the autonomy of the States by reducing the role played by discretionary grants in the growth of centralization, that the third Finance Commission recommended that "the total amount of grants-in-aid should be of an order which would enable the States, along with any surplus out of the devolution

[19]India, *Third Finance Commission Report, 1961*, para. 40, p. 20.
[20]*Ibid.*, para, 89, p. 38.
[21]*Ibid.*, para. 44, p. 21.
[22]*Ibid.*, para. 84, p. 36.
[23]*Ibid.*, para. 66, p. 30.
[24]*Ibid.*, para. 96, p. 40.

to cover 75 per cent of the revenue component of their Plans".[25] The same concern for State autonomy is reflected in the Commission's attempt to draw attention to "the mounting interest liability which is devolving on the States both on loans raised by themselves and loans granted to them by the Union Government"[26] and in the question raised by it whether it would not be advisable to have a period of moratorium on interest followed by a period of weighted rate of interest to compensate the Union Government for the interest foregone over the period of moratorium.[27] The same attitude may be seen in the Commission's suggestion regarding the appointment of "an independent Commission" to undertake a comprehensive examination to assess the tax potential of each State, to review its tax structure and to recommend rates under different heads of levies in the State list. The proposed Commission, it was suggested, would also consider "what adjustments, if any, should be made in Union-State financial relations which would add strength to both the Union and the States".[28] In view of all this evidence, there is obviously no warrant for the view that "the Union Government, under the influence of the Finance Commission, exercises a dominant role over the finances of the State Governments and, thus, perhaps reduces the autonomy of the States to a large extent".[29] The Union Government does exercise a sort of financial paramountcy over the States but this is by no means done "under the influence of the Finance Commission".

There is another aspect of the Finance Commission's work which has an important bearing on the working of the Indian federal system. In assessing the needs of the States and determining the proportions in which the States, individually, should share the Central assistance, the Finance Commission has been guided, *inter alia*, by the principle that "the scheme of distribution should attempt to lessen the inequalities between the States".[30] Marked disparities of economic development and standards of social services in the different units is striking but by no means an exclusive feature of the Indian federation. Through its recommendations, the Finance Commission has made a significant contribution towards correcting, to some extent, the disequilibrium of resources not only as between the Union and the States but also as between the States *inter se*. Keeping before itself the ideal of maximum national welfare, the Commission has, in some measure, geared its proposals to the need of "equalizing the standards

[25]India., *Third Finance Commissions Report, 1961, op. cit.*, para. 71, pp. 31-32.
[26]*Ibid.*, para. 100, p. 41.
[27]*Ibid.*, para. 101, p. 42.
[28]*Ibid.*, para. 93, p. 39.
[29]B.R. Misra, *op. cit.*, p. 91.
[30]India, *First Finance Commission Report, 1952, op. cit.*, p. 8.

of social services" in different States. This naturally means that Central assistance should be relatively larger in the case of backward States since "a principle of proportionate allocations will merely perpetuate under-development in these States".[31] Thus the first Finance Commission observed: "grants-in-aid may be given to help a State to meet special burdens and obligations of national concern, although within the State sphere, if they involve an undue burden on its finances".[32] This principle has also been followed by the Finance Commission in regard to the devolution of tax revenue.

When income-tax proceeds were made divisible under the Government of India Act, 1935, the Niemeyer Award allocated 50 per cent of the net proceeds for distribution among the provinces. As regards allocations from the divisible pool to different provinces the principle declared was that of achieving 'financial equilibrium' and of ending the "chronic state of deficit" in some provinces.[33] However, in the actual scheme of distribution recommended in the award, population and collection were given roughly equal weight, resulting in a greater differential advantage to the industrially advanced provinces like Bombay and Bengal. Thus the award actually ignored the greater fiscal needs of backward provinces and tended to accentuate rather than reduce the disparity of resources. The first Finance Commission made a radical departure from the precedent set by the Niemeyer Award, not only by raising the quantum of the States' share of the net proceeds of income-tax from 50 to 55 per cent but (in determining the share of each State separately) by giving a much greater importance to the factor of population, 80 per cent as against 20 per cent for collection, as a "broad measure of need".[34] This was evidently done with a view to reducing the disparity in the resources of the States. The second Finance Commission, while raising the States' share from 55 to 6 per cent, expressed itself in favour of completely abandoning the factor of collection as a basis for computing the shares of different States in the divisible pool. It was merely in order to avoid a sudden break in continuity that it recommended that the distribution of the States' share should be 10 per cent on the basis of collection and 90 per cent on that of population. This, the Commission felt, "should make it easy to complete in due course the process of eliminating the factor of collection altogether

[31]The Expert Committee of the Constituent Assembly on the Financial Provisions of the Constitution also emphasized the need for giving special grants to the poorer States and, in this regard, considered the methods used by the Commonwealth Grants Commission of Australia. The problem was, however, left to be dealt with by the Finance Commission.

[32]*First Finance Commission Report*, *op. cit.*, p. 97.

[33]*Indian Finance Enquiry Report* by Sir O. Niemeyer, 1936, p. 4.

[34]*First Finance Commission Report*, *op. cit.*, 1952, p. 105.

and the distribution of the entire amount of the States' share on the basis of population".[35] This, evidently, was a very important move in the direction of reducing the disequilibrium of resources among the States. The third Finance Commission recommended a reversion to the relative weightage given by the first Finance Commission to collection and population, but this was done in view of the fact that the tax paid by companies was excluded from the divisible pool and that States having larger collections had special problems relating to the maintenance of law and order and the administration of social services.[36] At the same time, it was no less emphatic that the previous Commissions in pointing out the need for correcting the disequilibrium and lack of balance between financial capacity and financial need which characterizes the different States in the Indian Union.

The Finance Commission has followed a similar approach in regard to the devolution of tax revenues. Thus the third Finance Commission has stated : "We consider that while population should continue to be the major factor for distribution, the relative financial weakness of the States, the disparity in the levels of development reached, the percentage of scheduled castes and tribes and backward classes in their population, etc., should be taken into account in determining the share allocated to each State individually".[37] Further, it is in an attempt to lessen inequalities between the States that the first Finance Commission recommended a special-purpose grant to some States for expanding primary education and the third Finance Commission recommended a similar grant for the improvement of communications. In both cases, the grants were recommended under Article 275(1) of the Constitution. While the principle of 'levelling up' has been generally welcomed, there has been some criticism that the actual recommendations of the Finance Commission have fallen far below the ideal proclaimed and that "they should have kept before them the necessity for substantial assistance to the backward States to enable them to raise their standards of all the services".[38] The Commission, it is said, has failed to use the balancing factor incorporated in the Constitution to the maximum advantage.

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[35]*Second Finance Commission Report, op. cit.*, 1956, para. 105, p. 40.

[36]*Third Finance Commission Report, op. cit.*, 1961, para. 35, p. 18.

[37]*Ibid.*, para, 47, p. 22. In this matter, the third Commission has taken a position essentially different from that of the two earlier Commissions both of which felt that such considerations as the proportion of scheduled castes or tribes and backward classes in the population of a State, its area and backwardness, etc., are not relevant to a scheme for the distribution of a tax *Second Finance Commission Report*, para. 104, p. 39.

[38]R.N. Bhargava, *The Theory and Working of Union Finance in India*, London, George Allens & Unwin, 1956, p. 122.

It is clear from the above analysis that the Finance Commission has regarded it as one of its functions to "safeguard the position of the States" and to counteract the tendency of the Central assistance to the States to be discretionary in character and "not on the principle of uniform application".[39] However, the scope of the Finance Commission's role as a balancing wheel of the Union-State financial relations has been somewhat restricted by the activities of the Planning Commission. According to the third Finance Commission, "the role and function of the Finance Commission, as provided in the Constitution, can no longer be realized fully due to the emergence of the Planning Commission as an apparatus for national planning". Each of the three Finance Commissions has been appointed *after* the formulation of successive Five Year Plans. The result of this arrangement is a certain amount of "overlap of functions" to which the second Finance Commission drew pointed attention. What is more important, it is the Planning Commission which determines the size of the Plan, lays down priorities, decides the quantum of resources to be committed, the additional resources to be raised by the Centre and the States and the assistance to be given by the Centre to the States. When the Finance Commission begins its work, it is required to keep in view the requirements of the Plan. The result is that it has to function within the lines already drawn by the Planning Commission. Against this background, declared the third Finance Commission:[40]

> The role of the Finance Commission comes to be, at best, that of an agency to review the forecasts of revenue and expenditure submitted by the States and the acceptance of the revenue element of the Plan as indicated by the Planning Commission for determining the quantum of devolution and grants-in-aids to be made; and, at worst, its function is merely to undertake an arithmetical exercise of devolution based on amounts of assistance for each State already settled by the Planning Commission, to be made under different heads on the basis of certain principles to be prescribed.

While it would be wrong to conclude from this that the Finance Commission has become "a servant of the Planning Commission", it is clear that the situation is rather anomalous and that there is obvious need for a better definition of the respective roles of the two Commissions and for greater coordination between their activities. The third Finance Commission's view that either the Commission's scope should

[39] *Third Finance Commission Report, op. cit.*, para. 79, p. 35.
[40] *Ibid.*, para. 79, p. 35.

be considerably widened or that the Planning Commission should itself be transformed into a Finance Commission at the appropriate timing bringing the problem into sharp focus.[41]

[41]India, *Third Finance Commission Report*, *op. cit.*, para. 82-83, pp. 35-36.

Centre-State Financial Relations*

Ramashraya Sinha

IN A FEDERAL polity which necessarily presumes division of powers and resources between two sets of governing authority—the Centre and the States—conflicts and tensions between the two are inevitable. This problem is as old as federation itself and has troubled almost all federations throughout the world. The United States, whose constitution has proved to have possessed remarkable capacity to endure and has made many experimentations and adjustments in federal-state relations, has passed through numerous such stresses and strains all along. The issue of national versus states' rights in that country has always been alive and the pendulum has been swinging sometimes in favour and sometimes against the States. Canada too has been witnessing this problem. Today there have not only been advocates of greater autonomy for its provinces, but even of sovereignty for the province of Quebec on ethnic and language ground. The Parti Quebecois with its promise of a referendum within two years on the issue of Quebec's secession from Canada has won a considerable number of seats in the new National Assembly.[1]

All this shows that no federation can claim immunity from differences between the Union and the States. In fact, a federal polity based upon shared power can be said to have 'institutionalised tension'.[2] Hence the mounting differences between the Centre and the States in India and severe strain through which the Centre-State relations have been particularly after the coming into being of the Janata Party Government at the Centre and the governments of different political hues in the States, are not peculiar.

*From *Indian Journal of Public Administration*, Vol. XXV, No. 2, April-June, 1979, pp. 388-408.

[1]"Parliamentary Developments, November 1976—January 1977", *Parliamentary Affairs*, Vol. XXX, No. 2, Spring 1977, p. 139.

[2]"Institutionalised tension", though used in a wider context, has been borrowed here from Alpheus T. Manson's *The Supreme Court: Palladium of Freedom*, Ann., Michigan: University of Michigan Press, 1962, p. 8. Mansion has called the government of the United States as "institutionalised tension" because the different organs of the government attempt to compete to attain a dominant political position.

REPERCUSSIONS

It cannot be denied, however, that the issue has been gathering disproportionate dimension here and the need for a fresh distribution of functions and financial resources between the Centre and the States is much emphasised. Amidst this controversy the issue of fiscal relations has acquired much greater dimension as the existing scheme of distribution of resources is considered to have placed the Centre in a superior position.

The West Bengal Government document[3] on Centre-State relations (adopted in its cabinet meeting on December, 1977) demands a thorough revision of the Centre-State relations and also calls for amending the Articles concerning the distribution of resources between the Union and the States. Very recently, provoked by the Planning Commission guidelines sent to the States for the formulation of their plans and the Prime Minister's letter to them regarding their performance in the field of family planning, the West Bengal Government, in order to secure greater autonomy, has intensified its campaign for the revision of the Centre-State relations. The West Bengal Finance and Planning Minister declared the other day that the Planning Commission had no mandate to issue such guidelines and these were not applicable to them.[4] Replying to the general discussion on the budget for 1978-79 in the State Assembly the Karnataka Finance Minister also pleaded for a proper fiscal federalism and observed that the fiscal relations between the Centre and the States required reconsideration. He called for a national debate and consensus on the issue.[5] In the first ever conference of southern chief ministers, meeting on their own without reference to the Central Government, they asked the Centre to increase the share of the States in the divisible pool of taxes collected by it to 75 per cent in the year as an *ad hoc* measure till a final decision is taken and they wanted the other chief ministers to support this demand.[6] The demand for rethinking has now acquired such a momentum that even the Union Finance Minister has to concede the need for a review of the Centre-State fiscal relations.

CONSTITUTIONAL PROVISIONS

Under the existing scheme of distribution the taxing powers of the Centre and the States have been completely separated and unlike the

[3]Information and Public Relations Department, Government of West Bengal, No. 1010 (450) IPR/P.

[4]*The Times of India*, June 24, 1978.

[5]*Ibid.*, July 3, 1978.

[6]*Ibid.*, July 18, 1978.

other federations of the world there is no concurrent jurisdiction. By and large taxes that have an inter-State base are levied by the Centre and those with a local base by the States.

The Union list contains 12 items of taxation and these taxes fall under five categories:

1. Taxes levied by the Union but collected and appropriated by the States;[7]
2. Taxes levied and collected by the Centre but assigned to the States, *viz.*, succession and estate duties, terminal taxes on passengers and goods carried by railway, sea or air; taxes on railway fares and freight, etc ;[8]
3. Taxes levied and collected by the Centre and compulsorily distributed between the Union and the States, *viz.*, taxes on income other than agriculture;[9]
4. Taxes levied and collected by the Centre and may be distributed between the Union and the States, if Parliament by law so provides, *viz.*, Union excise duties, excise on medical and toilet preparations;[10]
5. Taxes levied and collected and retained by the Centre, *viz.*, customs, corporation tax, surcharge on income tax.[11]

The State list contains 19 items, *viz.*, land revenue, liquor and opium excise, stamps, agriculture income, sales and purchase taxes, taxes on land and buildings, terminal taxes on passengers and goods, taxes on consumption and sale of electricity, taxes on vehicles, animals and books, amusements, betting and gambling profession, trade and callings, etc. Every State is entitled to levy, collect and appropriate these taxes.

In addition to these resources of the States, provisions have also been made in the constitution for giving assistance to them in the form of grants and loans. Article 275 empowers Parliament to give financial assistance to the States in need of such assistance and Article 282 empowers the Centre to make public purpose grants to the States and to any institution within the States. Further, the Centre is also empowered under Article 293 to grant loans to the States and also to give guarantee in respect of loans raised by them.

There is also provision for appointing a finance commission quinquennially for deciding the principles of distribution of revenues earned from income tax, and the grants-in-aid.[12]

[7] Article 268 (i).
[8] Article 269 (i).
[9] Article 270 (i).
[10] Article 272.
[11] See the 7th Schedule and Article 271.
[12] Article 280.

CRITICISM

The existing arrangement, undoubtedly, has tilted the balance "rather heavily in favour of the Centre".[13] The States have to derive a substantial part of their income from tax-sharing, grants and loans from the Central Government. While in 1950-51, 24 per cent of the revenue and capital expenditure of the States was financed by the Central resources, in 1960-61, 1970-71 and 1977-78 this proportion increased to 39 per cent, 45 per cent and 46 per cent respectively.[14] If taken plan-periodwise, the dependence of the States on the Centre was 41.4 per cent of their total revenue and capital expenditure in the First Plan, 48.5 per cent in the Second Plan, 52.2 per cent in the Third Plan, 53.7 per cent during 1966-67 Annual Plan and as high as 56.7 per cent during the Fourth Plan.[15] These figures speak for themselves as to how extremely dependent are the States on the Centre.

Because of this the current financial arrangement has attracted severe criticism from many quarters. Prof. D.T. Lakdawala (the Deputy Chairman of the Planning Commission) has said that "the present distribution in India unduly favours the Union Government. In no other established federation is the right to levy direct taxes, *i.e.*, income tax, corporation tax and estate duties (with few exceptions) so exclusively denied to the States.[16] In regards to loans, too, he has observed that "the dependence of the States on the Centre is more overriding because of various restrictions over them."[17] He is critical of Article 271 as well under which "Parliament possesses unhindered right to levy a surcharge on income tax for purposes of the Union and excise duties are shareable only at the discretion of Parliament which can levy excise duties or enhance them without making the proceeds therefrom shareable with the States."[18] All this, he emphasises, "militates against an important principle of federal finance, of the responsibility on each layer of raising its own resources to meet the expenditure decided to be incurred on its functioning, and that therefrom there is need of either giving the States additional resources of income, or of reducing their functions."[19] As the States are responsible for some of

[13]S.N. Jain, Subhash C. Kashyap and N. Srinivasan, (eds.), *The Union and the States*, Delhi, National Publishing House, 1972, p. 11.

[14]Himmat Patel, "Growing Indebtedness of the States", *Mainstream*, Vol. XVI, No. 39, May 27, 1978, p. 16.

[15]*Ibid.*

[16]D.T. Lakdawala, "Union-State Financial Relations", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 187.

[17]*Ibid.*, p. 188.

[18]*Ibid.*, p. 191.

[19]*Ibid.*, p. 187.

the basic and core functions like health, education, agriculture, etc., they naturally need adequate finance. But instead they are 'starved of financial resources'.[20] As under the existing arrangement the States lack productive heads of taxes the resources of most of the States fall short of meeting their expenses of even normal administration. The corporation tax has been excluded from the scope of sharing and the income tax paid by the companies has been reclassified as corporation tax, and thus gets excluded from the divisible pool of income tax. Even the rates of the additional excise duties to be shared with the States have been kept sticky, while special and auxiliary duties on it have been kept out of the divisible pool. Also the proportion of the basic excise duties to be shared with the States has been reduced from 40 per cent to 20 per cent since the third Finance Commission.[21]

CENTRAL ASSISTANCE

The current principles for distributing Central assistance, though rationalised much, have still been affecting adversely the position of the States. So far as the Central assistance in the form of grants-in-aid under Article 275, given in accordance with the recommendations of the Finance Commission and given with a view to levelling off the economic status of the various States, is concerned, there has not been much resentment. But the Central assistance which is given under Article 282 and which is basically discretionary has met with severe criticism. This provision though incorporated in the Constitution as a contingency measure, has now come to play a major role with the coming into being of the Planning Commission, through which is defrayed the plan assistance to the States

The Central assistance under Article 282 is meant, first, to bridge the gap between a State's own resources and its plan requirements and, secondly, for additional schemes sponsored by the Centre. The way it has been given to the States has led not only to their over-dependence financially on the Centre, but has bred financial indiscipline and irresponsibility in the States' fiscal conduct also. The Working Group on State Finances and Centre-State Financial Relations set up by the Study Team on Financial Administration of the Administrative Reforms Commission (ARC) drew up the following ill-consequences of such assistance.[22].

[20]H.K. Paranjape, "Centre-State Relations in Planning", in Jain, Kashyap and Srinivasan, *op. cit.*, p 217.

[21]P.D. Shrimali, "Trends in Union-State Fiscal Relations", *Mainstream*, Vol. XVI, No. 38, May 20, 1978, p. 20.

[22]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*, Vol. I & II, May 1967, Delhi Manager of Publications, Government of India, 1968, p. 399.

(*a*) The States are initiated to take up schemes without adequate planning and examination of the available local resources in man power and materials for implementing the scheme;

(*b*) The prescribed pattern required for staff, equipment and buildings content which is adopted by the States in order to earn assistance irrespective of the local conditions and situations for implementation;

(*c*) The States' plans are overburdened by multiple schemes, taken up from time to time as and when Central assistance is offered by the Centre on certain patterns during the course of plan period also; and

(*d*) The process of planning from below for schemes implemented at district, block and village level is to a certain extent hampered by the pre-determined patterns of Central assistance for individual schemes which fill up a substantial portion of the States' plan content.

As the States, particularly the deficit ones, were facing numerous difficulties in getting Central assistance, the procedure for its payment was revised in 1958.[23] Again in October 1964 the Central Government decided to liberalise the procedure.[24] When towards the end of the Third Plan the financial situation in several States was getting difficult a further liberalisation was made.

In order to further rationalise the principles for determining the quantum of Central assistance the National Development Council (NDC) asked the Planning Commission to evolve objective principles.[25] In August 1966, the Planning Commission laid down the following guidelines for each State for the period of the Fourth Plan as then envisaged:[26]

1. Every State should receive first the quantum of 70 per cent of the total amount to be distributed in proportion to its population;
2. the balance should be distributed after taking into account: (*a*) the special needs of Assam, Jammu & Kashmir, and Nagaland; (*b*) the commitments of some of the States required to spend larger amount on continuing schemes of irrigation and power which are of national importance; and (*c*) the requirements to ensure accelerated development of certain backward regions, hilly areas, etc.

[23]For detailed changes in the procedure see, *Report of the Study Team on Financial Administration, op. cit.*, p. 400.

[24]*Ibid.*, p. 401.

[25]*Ibid.*, 402.

[26]"The Case of the States", *Link*, August 27, 1978, p. 12.

Again in May 1968 when a new Fourth Plan (1969-74) was to be formulated a committee of NDC consisting of State Chief Ministers with D.R. Gadgil, the then Deputy Chairman of the Planning Commission, as its chairman evolved a formula, which "envisaged a lump sum amount to be set apart for meeting the requirements of Assam, Jammu & Kashmir and Nagaland. The balance of Central assistance was to be distributed among the States in the following manner: (*i*) 60 per cent on the basis of population; (*ii*) 10 per cent on the basis of per capita income to States having per capita income below national level; (*iii*) 10 per cent on the basis of tax effort determined on the basis of per capita receipts from State taxes as percentage of per capita State income; (*iv*) 10 per cent continuing major irrigation and power projects; and (*v*) 10 per cent for special problems of States. It was also decided by the NDC committee that the assistance should be in the shape of block loans and grants for a State plan as a whole, without being related to any sector of development or a particular scheme. It was agreed that the assistance should be 30 per cent by way of grants and 70 per cent by way of loans. For the hill areas of Assam, Jammu & Kashmir and for Nagaland, a more liberal pattern of 90 per cent grant and 10 per cent loan was adopted. For the hill areas of Uttar Pradesh, Tamil Nadu and West Bengal the assistance was in the shape of 50 per cent grant and 50 per cent loan."[27] When the Fifth Plan was being finalised, the formula was again revised and it was decided to continue it with updated calculation.[28]

THE FINANCE COMMISSION AND THE PLANNING COMMISSION

But despite all these attempts to rationalise the principles for distributing Central assistance its multiple patterns have, undoubtedly, led to erosion of States' status. The Planning Commission, as a result of these patterns, has come to play a very significant role in the allocation of resources to the States and in the process it "has eclipsed, in an unmistakable way, the role of the Finance Commission."[29] Because of planning and its consequent effect the States all the time look up to the Centre. Though the Finance Commission was an innovation of the constitution in the matter of Centre-State finances, the 'quantitative significance' of its recommendations has been deteriorating with the expanding scope of the Planning Commission. As the development expenditure is in the patronage of the Planning Commission, with the accelerated increase in such expenditure the dependence of the States

[27] *Link, op. cit.*, p. 12.

[28] *Ibid.*

[29] S.R. Maheshwari, *The Administrative, Reforms Commission*, Agra, Lakshmi Narain Agrawal, 1972, p. 101.

on the Centre has deepened. This has led D.R. Gadgil to say that "...the administration of grants, with usual examinations as to the admissibility of expenditure, etc., places very considerable power, often unfairly used, in the hands of inspecting officers of the ministries and the Planning Commission. The total result is the undermining of the initiative of State authority and the building up of feelings of resentment."[30] The quantum of the transfers of financial assistance by the Planning Commission and the Finance Commission shows that "of the two pipelines, that of the Planning Commission has been larger."[31]

As both the Planning Commission and the Finance Commission are engaged in the apportionment of the financial resources to the States their functions "have tended to overlap at many points" and "it has created not an inconsiderable amount of confusion in the criteria adopted in determining Central assistance."[32] This dichotomy has led to many conflicting results: (*i*) The estimates submitted by the State Governments to these two bodies are not consistent because in order to squeeze more from the Finance Commission which is engaged in filling the revenue gap through statutory grants, the States are tempted to present underestimated figures of their resources;[33] (*ii*) in the process some wealthy States fudge the figures;[34] (*iii*) the distribution between the plan and non-plan expenditure is false;[35] and (*iv*) "a major contradiction and irrationality in the functioning of these two bodies arise because the datum used is different. Hence they act at cross purposes."[36]

The Finance Commission, which is set up to "decide over the competing and conflicting claims of the Union, the States and the States *inter se*"[37], and which was expected, at the time of the framing of the constitution, to suggest even changes in the constitutional provisions is, thus, relegated to the backgear. But all the seven Commissions, so far set up, "have been precluded from taking on this rather important study, since this has been kept outside their terms of reference."[38]

The operation of the Planning Commission has, undoubtedly, given considerable liverage in respect of State plans and programmes and its role in this regard "is much more wider and in terms of magnitude

[30]Quoted in Pran Chopra, *Uncertain India*, Bombay, Asia Publishing House, 1968, p. 209.

[31]S.R. Maheshwari, *op. cit.*, p. 101.

[32]*Report of the Study Team on Financial Administration, op. cit.*, p. 361.

[33]*Ibid.*, p. 364.

[34]*Ibid.*

[35]*Ibid.*

[36]*Ibid.*

[37]J. Shivakumar, "Union-State Financial Relations", *Indian Journal of Public Administration*, Vol. XVI, No. 2, April-June, 1970, p. 206.

[38]*Ibid.*, pp. 206-7.

much more decisive and effective."[39] But at the same time it is claimed that for a uniform development of all regions, there would have been no better machinery than this. Notwithstanding its patriarch like approach, it is claimed to have been able to effect financial discipline in the States and to have played 'a genuinely national role'.[40] It is said to have contributed greatly to the direction of a great mobilisation of resources at the Centre.[41] It is argued that it has a distinct role in as much as investment planning and allocation of resources for the country's balanced development could not be entrusted to the Finance Commission or any Central department.[42]

But the role of the Planning Commission has been criticised not only because of its encroachments upon a "field which some regard as the sole preserve of the Finance Commission".[43] It faces the severe criticism because such encroachments have been made by a body which has developed "as a limb of the Government of India".[44]

The existing pattern is also unduly complicated. Ivor Jennings has observed that the problem of federal finance is complicated and the Constituent Assembly has provided a complicated solution. Such a system is unsatisfactory and deficient.[45] Santhanam emphasises that "not only are taxes to be collected and levied by the Centre of various kinds but the method of distribution also has become very complicated".[46] D.T. Lakdawala characterises the existing scheme as 'nebulous'.[47]

HISTORICAL PERSPECTIVE

It cannot be denied that "the distribution has given the Centre the resilient and expansive sources of revenue and given the States the inelastic and even eroding sources of revenue."[48] The allegation that

[39]*Report of the Study Team on Financial Administration*, Report of the Working Group, *op. cit.*, p. 363.

[40]H.K. Paranjape, "Centre-State Relations in Planning", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 210.

[41]D.T. Lakdawala, "Planning and Development", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 432.

[42]*The Times of India*, July 5, 1978.

[43]S. Shivakumar, "Centre-State Financial Relations", *Indian Journal of Public Administration*, *op. cit.*, p. 213.

[44]*Ibid.* p. 214.

[45]Ivor Jennings, *Some Characteristics of the Indian Constitution*, Oxford University Press, 1953, p. 72.

[46]K. Santhanam, *Union-State Financial Relations*, Bombay, Asia Publishing House, 1963, p. 33.

[47]D.T. Lakdawala, *Union-State Financial Relations*, Bombay, Lalvani Publishing House, 1967, p. 5.

[48]A.K. Chanda, "The Financial Apect of Union-State Relations". in Jain, Kashyap and Srinivasan, *op. cit.* p. 251.

the Centre has become "the banker and collecting agent for the States", is, no doubt, irrefutable. But one may not be oblivious of the strong factors which led to this situation. Seen in the historical perspective it is clear that the tradition of centralised system of federal finance which was inherited from the British rule had had its indelible impact on the scheme of distribution of financial resources between the Centre and the States in the new constitution.

Till "the Montague-Chelmsford Reforms all sources of revenue were centralised; all revenues, whether they accrued from land revenue or from customs or from any other sources, were treated as revenue of the British Crown and were allotted between the Centre and the Provinces."[49] For the first time after the introduction of the Montague-Chelmsford Reforms "the federal principle in the allocation of revenue between the two layers was initiated."[50] But since then this allocation has remained tilted in favour of the Central Government.

As the existing pattern of federal finance is mainly based on the financial provisions of the India Act of 1935 (except the creation of the Finance Commission), "which in turn embodied the accumulated wisdom and experience of fortyfive years that had elapsed since Lord Mayo's Financial Resolution of 1890,"[51] heavy degree of centralisation was bound to crop in. Notwithstanding the 1935 Act which was definitely the first attempt at federation making, it did not give the desired financial autonomy to the provinces. Preceding the Act there had been intensive and frequent discussion over the issue of federal finance. The reports of the Meston Committee (1920) and the Taxation Enquiry Committee (1924-25), the Lyton Scheme, the schemes proposed by the Simon Commission, the Percy Committee (1932), and the First (1931) and the Second (1932) Peel Committees were all looked into. Even the framers of the new constitution were found to be "heavily dependent on the studies of"[52] these bodies. The net result was that a centralised system of federal finance emerged.

Perusal of the *Constituent Assembly Debates* reveals that two 'new factors'—the unstable financial situation prevailing during the framing of the constitution and the 'need' of the provinces, particularly of the poor ones, for more financial assistance—"greatly reinforced the pressure toward centralisation exerted by these inherited constitutional pattern."[53] The 'need' factor, in fact, necessitated the Union to have

[49]K. Santhanam *op. cit.*, p. 30.

[50]D.T. Lakdawala, *Unions-State Financial Relations*, *op*, *cit*., p. 25.

[51]Alice Jacob, "Centre-State Governmental Relations in the Indian Federal System", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 59.

[52]See *Ibid.*, p. 60n and A.K. Chanda, *Federalism*, pp. 134-63.

[53]Granville Austin, *The Indian Constitution: Cornerstone of a Nation*, London, Oxford University Press, 1966, p. 22.

more financial resources of its own in order to distribute a portion of it amongst the States or to make grants to the States according to their needs and requirements. The compelling reason for the Centre to have full control over the elastic sources of revenue seemed, thus, to be the need for effecting equalisation in the States' resources. If left to have their own independent resources, the gulf between the rich and the poor States could not have been bridged or at least reduced and the poor ones would have been unable to meet their own responsibilities and obligations as is obvious from the statement of Pandit Kunzru in the Constituent Assembly that "If federation means anything, it means that there should be a transfer of wealth from the richer to the poorer provinces."[54] Even some of the provinces themselves wanted such arrangement in order to get required financial assistance from the Centre. Such provinces considered it the "duty of the Centre to give greater assistance to the poorer provinces."[55] The provisional government of the Central Provinces and Berar went even to the extent of suggesting that the Union's role be increased in this respect and "estate and succession taxes on agriculture land, for long provincial tax fields, should, for the sake of uniformity, be collected by the Union and distributed among the provinces."[56] The then Finance Minister was also in favour of the Centre having the maximum power of taxation.[57] As a result of all this it was finally decided that the most elastic, flexible and lucrative tax heads should be levied and collected by the Centre and thereafter distributed amongst the States according their needs.

It is not that the issue of financial autonomy was not raised in the Constituent Assembly. The provincial governments were conscious that "they should not have to place themselves completely at the mercy of the Union Government"[58] and had "put forward strong claims to an increased share of the proceeds from income tax and Union excise duties, as well as for a portion of corporation tax revenues."[59] But at the same time they "were willing to let the Union levy, collect and distribute these taxes and did not suggest that they be placed within the legislative competence of the provinces."[60] Though the Expert Committee on the Financial Provisions of the Constitution

[54] *The Constituent Assembly Debates*, IX, 6, quoted in Granville Austin, *op. cit.*, p. 222.

[55] *Ibid.*

[56] *Report of the Committee of the Whole of the C.P. and Berar Legislative Assembly*, forwarded to the Constituent Assembly, in Granville Austin, *op. cit.*, p. 223.

[57] *Ibid.*

[58] *Ibid.*, p. 218.

[59] *Ibid.*

[60] *Ibid.*

wanted the provincial governments to have "adequate resources of their own, without having to depend upon the variable munificence or affluence of the Centre,"[61] it did not recommended for wider areas of provincial taxation.[62] But the drafting Committee which broadly incorporated in the draft the recommendations of the Expert Finance Committee did not incorporate those recommendations relating to the distribution of revenues between the Centre and the States because under the then prevailing unstable financial conditions it thought it best to retain the then existing distribution for a period of five years at the end of which a Finance Commission might review the situation[63]

But the provinces felt dissatisfied with the scheme as was obvious from the statement of Dr. Rajendra Prasad that there was "a considerable feeling in the provinces that their resources of revenue have been curtailed."[64] Nevertheless, the issue was resolved in favour of a centralised finance as there was "a distinct tendency in the several federations for the central government to act as the taxing agency."[65] Thus the constitution makers were aware that while adopting the provisions of the Act of 1935 they were "making the States lean heavily on the Union for financial support. It was a deliberate act to provide for a measure of central coordination of social and economic activities of the States to ensure their balanced and harmonious growth."[66]

APPRAISAL

But despite a system of centralised finance the quantum of money transferred by the Centre to the States by way of tax sharing, grants and loans is substantial. The recommendations of the sixth Finance Commission in regard to the divisible share of States as also in regard to the grants-in-aid under Article 275 have led to a constant increase in the quantum of money transferred both in absolute terms and proportionately in respect of income tax, and in respect of excise duties only in absolute terms. In fact the States have been put in a better position in comparison to their counterparts in the United States; without levying many taxes they have been getting substantial amount

[61] Quoted in Granville Austin, *op. cit.*

[62] *Ibid.*

[63] B.R. Ambedkar's forwarding letter with the draft constitution to the President of the Constituent Assembly, *Draft Constitution of India,* New Delhi, The Manager, Government of India Press, 1948, p. xi.

[64] *Constituent Assembly Debates,* X, 9, p. 340.

[65] *Constituent Assembly Debates,* VII, 5, pp. 336-7.

[66] Ashok Chanda, "The Financial Aspects of Unicn-State Relations", *op. cit.,* p. 251.

from the Centre. In the current year "the States and Union Territories' plans together will be larger than the Central plan."[67] The very fact that "between 1951-52 and 1969-70 the proportion of States' shared taxes and grants-in-aid to their shared taxes has increased from 22 per cent to 27 per cent and in absolute terms from Rs. 87 crores to Rs. 1,037 crores"[68] is suggestive that the States have been getting substantial amount of money from the Centre. If loans given to the States during this period are taken into account, "the ratio increases from 29 per cent to 50 per cent and magnitudes from Rs. 160 crores to over Rs. 1,821 crores."[69]

It is a fact that the States' indebtedness has grown during all these years which is in reality the indebtedness to the Centre. Such indebtedness has increased with such a pace that the Central loans which amounted for only 53.7 per cent of the total debts of the States in 1951-52 increased to 74.1 per cent in 1970-71 and slightly declined to 70.8 per cent in 1976-77.[70] As a result the debt serving charges have also increased.[71] All this has naturally made the States extremely dependent financially upon the Centre. Even the contention that the loans advanced by the Centre "have become merely book transactions"[72] may not be refuted. But an important aspect to be considered is that the States have not been able to develop financial discipline and they have lagged behind in mobilising their own resources.

Nevertheless, what is clear from the foregoing analysis is that though the Centre has been transferring a substantial amount of money by way of shared taxes, grants and loans, the States have no major elastic and independent source of revenue commensurate with their developing needs. This is considered to have been making the States' financial position not only difficult but impinging on the very principle of federation.

PROPOSALS AND RECOMMENDATIONS

By now various proposals and recommendations for effecting changes in the existing position have been made. A three-man

[67]The Finance Minister Budget Speech, *Commerce*, Vol. 136, No. 3484, March 18, 1978, p. 89.

[68]J.D. Sethi, "Union-States Economic Relations", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 281.

[69]*Ibid.*

[70]Himmat Patel, "Growing Indebtedness of States", *Mainstream*, May 27, 1978, p 15.

[71]*Ibid.*

[72]K. Santhanam, in Jain, Kashyap and Srinivasan, *op. cit.*, p. 439. Santhanam writes that "in 1970-71 the Centre was to give above 1.847 crores to the States but it had to collect Rs. 600 crores by way of repayment of the instalments of old loans and Rs 200 crores by way of interests".

Committee constituted by the Government of Tamil Nadu under the the chairmanship of Dr. P.V. Rajamannar on September 22, 1969 to examine the entire question of Centre-State relations recommended among others that:[73] (*i*) the base of the devolution of resources on the States should be widened by including: (*a*) corporation tax, (*b*) customs and export duties, and (*c*) tax on the capital value of assets, in the divisible pool; (*ii*) all excise duties and cesses, special regulating or otherwise, which are at present shareable at the option of the Union, should be made compulsorily divisible; (*iii*) additional duties of excise should be continued only with the concurrence with the States; (*iv*) taxes levied and collected by the Union but assigned to the States under Article 269 should be only levied by the Centre but the collection might be left to the States; (*v*) the surcharge on income tax should be merged with the basic rate of income tax so that it could be shared with the States; (*vi*) in future no surcharge should be levied except with the consent of a substantial majority of the States; (*vii*) restrietions on the power of the States to levy tax on the consumption or sale of electricity under Article 287 should be omitted; (*viii*) grants by the Centre to the States, both for plan and non-plan expenditure should be made on the recommendations of an independent body like the Finance Commission which should be a permanent body and whose recommendations should be statutorily binding on all parties—the Centre as well as the States; (*ix*) a committee might be set up to consider the issues relating to loans and indebtedness of States. The committee might also consider the desirability of constituting an authority, like the Australian Loan Council or forming a development bank on the lines of the World Bank to deal with loans; and (*x*) the role of the Planning Commission should be confined only to tender advice on schemes formulated by the States.

The West Bengal Government document on the Centre-State relations suggests[74] that; (*i*) the Articles regarding the Finance Commission and the distribution of revenues should be amended to provide for 75 per cent of the total revenues raised by the Centre from all sources for allocation to different States by the Finance Commission; (*ii*) it should not be the task of the Finance Commission to decide on the proportion of revenues to be distributed between the Centre and the States. Its task should be only to fix the proportion each State should get from the total financial realisation by the Centre, 75 per cent of which is to be allotted to the States; (*iii*) the States must also be accorded more powers for imposing taxes on their own and to determine the limits of public borrowing in their respective ones; (*iv*) the

[73]*Report of the Centre-State Relations Inquiry Committee*, Madras, Government of Tamil Nadu, 1971.

[74]*The West Bengal Government Document on Centre-State Relations, op. cit.*

right of the Union Government to tax property and income of the States in certain cases as provided in Article 280 (2) and (3) should be removed; and (*v*) the right of the Union Ministry to put restrictions on trade and commerce and intervene within a State as provided in Article 302 should be deleted.

Santhanam once suggested that the share of income tax or excise duty to be given to the States should be made statutory and the jurisdiction and function of the Finance Commission should remain confined only to the determination of the quantum of the grants. It would then, he maintained, proximate more or less to the Commonwealth Grant Commission[75] and thus it would be easy to determine the grants in accordance with the needs of the States.[76] A.K. Chanda has suggested the possibility of "a permanent settlement by assigning to the States 90 per cent of the income tax with the Centre retaining the right of levying of surcharge when needed.[77] He opines that 40 per cent of the excise duties should be handed over to the States[78]. Suggestions are also made, as recommended by the Rajamannar Committee, for making corporation tax and surcharge on income tax, which exclusively go to the Centre at present, shareable between the Centre and the States.

The chairman of the First Finance Commission also came forward with a proposal for establishment of an independent body with its own secretariat to deal with all kinds of financial assistance by the Centre to the States. A proposal that a national development bank should be set up for the purpose of distributing Central assistance was also made by the Study Team on Financial Administration[79] set up by the ARC and also suggested by Prof. D.T. Lakdawala[80] and others. But the establishment of such a body was disfavoured by the ARC and others on several grounds.[81]

[75]The Commonwealth Grant Commission is an independent expert body set up in Australia to consider applications by States for grants from the general government and to make recommendation to it.

[76]K. Santhanam in Jain, Kashyap and Srinivasan, *op. cit.* p. 439.

[77]A.K. Chanda, in Jain, Kashyap and Srinivasan, *op. cit.*, p. 257.

[78]*Ibid.*

[79]*Report of Study Team on Financial Administration, op. cit.*, p. 89.

[80]D.T. Lakdawala says that such a body "will go far to put this form of assistance on a rational basis", in Jain, Kashyap and Srinivasan, *op. cit.*, p. 432.

[81]S.R. Maheshwari, *op. cit.*, p. 224. See also G. Thimmaih, *An Approach to Centre State Financial Relations*, Mysore, Ganga Tharang Publishers, 1968 and his articles, "Planning and Federation", *Eastern Economist*, August 29, 1969; "Does India Need a National Loan Council", *Capital*, July 17, 1969 and "Centre-State Financial Relations: A Comment", *Economic and Political Weekly*, October 17, 1970. Thimmiah disfavours the setting up of such a body on the ground that such a body would not only, 'halt economic progress at the state-level for want of funds,'

(*Continued on next page*)

The ARC while looking into the Centre-State relations came to the conclusion that "the conflict between the Centre and the States has arisen not because of any faulty distribution of powers or resources between the Centre and the States, but because of the methods and procedures that have been followed in giving effect to the constitutional provisions."[82] While suggesting simplified procedure it recommended:[83]

1. The amount of total assistance to be given to a State should first be determined. The amount to be given in forms of loans should then be worked. The balance of the total assistance left after deducting the quantum of loans will be available for distribution as grants.
2. A certain portion of the amount available as grant should be tied to schemes or groups of schemes of basic national importance. The remainder should then be distributed *pro rata* over other schemes which are eligible for Central assistance.
3. If there is a shortfall in the implementation of State plan taken as a whole and as a result the Central assistance utilised by the State is more than what would be proportionate to the expenditure met by the State out of its resources (the correct proportion being one which will initially be settled at the time of finalisation of the plan), there would be corresponding reduction in the Central assistance.
4. 'Miscellaneous Development Loans' should be abolished after the introduction of the scheme of Central assistance in the manner prescribed above.
5. The number of centrally sponsored schemes should be kept to the minimum and the criteria laid down for determining which projects should be centrally sponsored should strictly be applied.
6. For reducing the indebtedness of the States there should be a classification of schemes into productive and non-productive schemes and productive schemes should qualify for loan assistance.
7. A sinking fund method for liquidation of the loans should be adopted.
8. The assistance for captital schemes which are non-productive

(Continued from previous page)
but would render overall economic planning ineffective by weakening the position of the Planning Commission and would further create the problem of coordination between the Planning Commission and the NDB on the one hand and the Reserve Bank on the other. *Vide* his "Comments", *Indian Journal of Public Administration*, Vol. XVII, No. 2, April-June, 1971, p. 285.

[82]S.R. Maheshwari, *op. cit.*, p. 123.

[83]*Ibid.*, pp. 125-28.

could be in the form of capital grants.

9. The Central grants under Article 282 should be governed by a set of definite principles to be recommended by the Finance Commission and the application of their principles should be left to the Planning Commission.
10. The appointment of the Finance Commission should be timed that it should have before it an outline of the five-year-plan as prepared by the Planning Commission.

Recently the NDC set up a committee to consider the question of transfer of larger resources to the States and for a revision of the Gedgil formula. The NDC committee which comprised mostly of the Chief Ministers was unanimous in its demand for a larger transfer of fiscal resources to the States.[84] Several of the Chief Ministers argued that not only tax sharing and plan assistance but the allocation of market borrowings and the flow of institutional finance to the States should be regulated on the basis of agreed principle which might be indicated by the NDC. The Chief Minister of West Bengal suggested that all available Central resources including tax receipts, market borrowings, external assistance, bank credit and deficit financing should be pooled and 75 per cent of the total available resources be transferred to the States. He proposed that a standing committee of the NDC should be set up to decide the principles on which the transferred amount should be allocated among the States and also to review the expenditure of the Central Government. All the Chief Ministers urged a change in the present position of 70 : 30 loans to grants in Central assistance. West Bengal proposed a 50 : 50 ratio whereas most others proposed 30 : 70. They argued that the terms of Central loans to the States should be liberalised in order to reduce the growing indebtedness of the States to the Centre.[85]

The NDC committee set up a working group under the chairmanship of D.T. Lakdawala to examine in depth the details of the various proposals and other qualitative implications made by the States and the question of Centre-State fiscal relations.[86]

Recently at a seminar on 'major issues of federal finance' organised by the National Institute of Public Finance and Policy the participants expressed themselves in favour of larger transfer of resources relating to the shareable taxes and wanted the Finance Commission to evolve suitable criteria to ensure that poorer and backward States received more assistance. They also wanted that all grants whether plan or non-plan should be made by the Finance Commission and the operation of

[84] *The Times of India*, August 23, 1978.
[85] *Ibid*.
[86] *Ibid*., August 24, 1978.

the Planning Commission should remain confined to giving loans. Some of them wanted the transfer of one or more taxes to the States, a constitutional demarcation of the respective roles of the Finance and Planning Commissions and the setting up of a permanent finance commission.[87]

Tarlok Singh, a former member of the Planning Commission has pinpointed the whole issue of Centre-State financial relations and federal finance to 'five-key-problems' which are also obvious from the foregoing analysis. These are:[88]

1. To enlarge the base for transfer of resources from Centre to the States so as to bring State resources and obligations nearer each other;
2. To ensure an integrated view of plan and non-plan grants to the States;
3. To reduce the burden of past debts and to evolve sound policies for productive loans to the States;
4. To enable the weaker States to become financially viable and to make more rapid progress towards reduction of inter-State and inter-regional disparities.
5. To ensure greater coordination in tax policy of the Centre and the States as well as sound fiscal management on the part of the States.

Various proposals and recommendations discussed in the foregoing analysis and the answers to the 'key-problems, can be reduced to the four-fold suggestions : (*i*) the States should have some more elastic sources of revenue and the corporation tax and surcharge on the income tax should also be made divisible; (*ii*) a proper and stable system of grants-in-aid by obliterating the distinction between plan and non-plan grants, and thus ending the dualism of the Finance Commission and the Planning Commission, should be developed; (*iii*) The Finance Commission should be made a standing commission; and (*iv*) loans should be advanced through a statutory authority.

COMPARATIVE PERSPECTIVE

But before arriving at a conclusion as to the desirability of any shift in the existing pattern of Centre-State relations, it seems pertinent to look at it in a comparative perspective. What has been said and

[87] *The Times of India*, July 5, 1978.

[88] Tarlok Singh, "Centre-State Financial Relation and Planning", *Indian and Foreign Review*, Vol. 15, No. 18, p. 14.

written on the prevailing state of these relationships in India betrays that it is only here that the principle of coordinate division of powers has been undermined and the States have been financially subordinated to the Centre and their budgetary autonomy has been adversely affected. But a close study of the operation of the system of federal finance in the United States, Canada, Australia and Switzerland, which are considered to be homelands of traditional federations and where the division of resources between the national and state governments is deemed to proximate greatly to the principle of coordinate division of powers, reveals that these federations too fall short of expected operation.

Despite constitutional framework giving an apparent idea of 'real federalism', compelling factors like war, depression and other social demands have greatly elevated the taxing powers of the national governments and to that extent taxing powers of the states are restricted.[89] The operation of these federations in financial fields clearly shows that:

> So far as taxation is concerned, only the general governments have any important method of taxation confined exclusively to them either actually or potentially. In all the four federations the raising and spending of revenue from custom duties have come to be given to the general governments alone. And two out of the four federations—Canada and Australia—the general governments seem to be empowered to make the methods of direct taxation also exclusive to themselves. In Switzerland the general government has entered the field of direct taxation and has excluded the regional governments from that field . . . In all four cases there remains to the regional governments no important taxing power which is not either shared with the general government, or liable to be taken over by the general government.[90]

Thus from the above quoted view of no less an authority on federation than K.C. Wheare it is obvious that in practice not even the traditional federal governments appear to have applied the federal principle *in toto*. In the United States, "national authority and influence have been deeply affected by the everwidening use of conditional grants-in-aid by Congress to the states and their sub-divisions."[91] Despite the criticism of the grant-in-aid technique as 'perverting' in its

[89] K.C Wheare, *Federal Government*, 4th ed., Oxford University Press (ELBS Publication), 1968, p. 105.

[90] *Ibid.*, p. 109.

[91] L.D. White, *Introduction to the Study of Public Administration*, 4th ed., New York, The Macmillan Company, 1955, p. 142.

influence, "a 'backstairs' approach to solving problems, and a violation of the spirit, if not the letter, of the Constitution,"[92] the quantum of grants has been on great increase as is obvious from the passage quoted below :[93]

> From less than $ 1 billion in 1946, federal aid to State and local governments had arisen to an estimated $20.3 billion for fiscal 1969 (July 1, 1968 through June 30, 1969). The expectation was that by 1975 it would total between $ 50 and $ 60 billion. In January, 1967, Senator Edmund S. Muskie reported that "during the past six sessions, Congress has . . . appropriated more federal aid money than in all the previous Congresses going back to 1789."[94] In March, 1967, in a message to the Congress on the 'Quality of American Government', President Johnson stated, "This year alone, some 70 per cent of our federal expenditures for domestic social programmes will be distributed through the State and local governments.[95]

In fact through the system of grants "the spending power has been developed as a potent weapon by the national government in securing state cooperation in many fields" as the states have to necessarily agree to the conditions attached to the grants.[96] Thus the system of grants and other provisions and practices of federal finance show that in the US, too, the general government "has on its side potent purse powers, the result of superior tax-gathering resources."[97]

It is not that recommendations have not been made in the US for a change in the present system. There have been many proposals that instead of the present system the federal government should share its revenues with the states, making block grants 'with no strings attached'.[99] Even there have been made some beginnings on revenue sharing without federal strings.[99] But by and large the national

[92]Gay B. Hathorn, Howard R. Penniman and Mark F. Ferber, *Government and Politics in the United States,* (2nd ed.), New Delhi, Affiliated East-West Press, 1966, p. 60.

[93]Felix A. Nigro, *Modern Public Administration,* 2nd ed., New York, Harper and Row Publishers, 1970, p. 137.

[94]Quoted in Felix A. Nigro, *op. cit.*, from Senate Sub-Committee on Intergovernmental Relations, *Creative Federalism,* Part 2-4, the State Local-Regional Level, 90th Congress, Washington D.C., Government Printing Office, 1967, p. 472.

[95]*Ibid.*, p. 473.

[96]Guy B. Hathorn, Howard R. Penniman and Mark F. Ferber, *op. cit.*, p. 60.

[97]Morton Grodzins, "The Federal System," in *Goals for Americans*, New York, Columbia University, 1960, pp. 265-282 reprinted in L. Earl Shaw and John C. Pierce, *Readings on American Political System* (Indian ed.) New Delhi, Sterling Publishers, 1972, p. 91.

[98]Felix A. Nigro, *op. cit.*, p. 141.

[99]*Ibid.*, pp. 141-142.

government, because of changing social structure and consequent demands upon it, has had its financial superiority and the centralising tendencies not only persist but also have been strengthened.

Despite the attempts of the Hoover Commission (1953-55), the Kestnbaum Commission on Intergovernmental Relations (1953-55) and the Joint Federal State Action Committee (1957-59) to separate functions and tax resources[100] the continuity of the 'collaborative system' has not only been maintained but rather strengthened. On the basis of the taxation and commerce powers as interpreted by the Supreme Court the national government has kept on widening its area of operation.

It is thus evident that it is not only in India, which is unlike the US, a federation as a result of a centralised state being decentralised into federating units (with the exception of the merger of native states), the Centre is much stronger financially also than the States, but in traditional federations, too, "the general governments have become incomparably much powerful financial authorities in their federal systems, and the regional governments have been reduced to a restricted, if not subordinate position".[101] This shows that no scheme of federal finance can be made to proximate with the principle of coordinate division of powers and centralising tendencies are not only Indian phenomena but universal ones.

CONCLUSION

The foregoing analysis, thus, leads us to conclude that what is needed in India at present in regard to the Centre-State relations is not sweeping changes in the existing pattern and as such the constitution is not required to be amended as has also been said by the ARC: "It is our firm view that the basic constitutional fabric of ours is quite sound and must remain intact. The constitution is flexible enough to ensure its successful working irrespective of which party may be in power, provided that those who are in power mean to work it and not wreck it. We are convinced that it is not in the amendment of the constitution that the solution of the problems of the Centre-State relationships is to be sought, but in the working of the provisions of the constitution by all concerned in the spirit in which the founding fathers intended them to be worked. There is no other way of ensuring cordial and fruitful Centre-State relations."[102]

The view of the ARC seems to be fact oriented and measured as any constitutional changes leading to stative scheme of division of

[100]For details see Morton Grodzins, "The Federal System", *op. cit.*, p. 78.
[101]K.C. Wheare, *op. cit.*, p. 109.
[102]S.R. Maheshwari, *op. cit.*, pp. 123-24.

resources, instead of solving the problem, will complicate them. Flexibility and not rigidity is the sustaining force of a developing federal constitution. Complete rigidity, either in statutory provisions or in practice or in both, instead of enduring the constitution, will wreck it. A constitution is not a transitory document, but is intended to endure for ages to come. Any rigid separation of resources between the Centre and the States instead of something the relationships and facilitating the situation arising out of changing power pattern of national and state politics, which is an inherent characteristic of parliamentary government, and more so of a federal system, is apt to complicate it.

Edmund Randolph, a member of the Convention's Committee on detail (US) was very correct when he wrote *inter alia*: "To insert essential principles only lest the *operations of government should be clogged by rendering* those provisions permanent and unalterable, which ought to be accommodated to times and wants." Hence the distribution of powers and resources in a federal constitution cannot be fixed rigidly for all times to come. Any attempt, therefore, to insert immutable provisions outlining the Centre-State relations in India will neither be efficacious nor problem solving. The first Hoover Commission was right when it said: "Emphasis shifts from generation to generation as the American people fashion their government to meet the needs of changing times and changing conditions."[103]

Nevertheless, as the Centre-State relations in India have been passing these days through a stage of acute controversy some adjustments between the powers and resources of the both sets of authorities become imminent. But such adjustments should not be preferred for principle's sake. Instead social and economic conditions leading to national integration should be the motivating forces.

Moreover, the goal achievements of a federal system, which is a part of the larger political system, does not entirely depend upon the inputs of the components—the Centre and the State—individually, but on their interactions as well. For this, the need is, first, to allay the apprehensions of the States that they are subordinated and to make them financially viable in order to cope with the growing societal needs. The apprehensions can be allayed by changing the discretionary nature of the Central assistance. This can be achieved by enlarging the scope of the Finance Commission by making it responsible for giving grant for both plan and non-plan expenditure. This can be effected by simply making the terms of reference of the Finance

[103]The Commission on Organisation of the Executive Branch of Government, *Overseas Administration, Federal-State Relations, Federal Research*, Washington, D.C., Government Printing Office, 1949, p. 25.

Commission, under Article 280(3)(c) more comprehensive as has been suggested by the ARC.[104] For this the appointment of the Finance Commission should be synchronised with the launching of the plan.

For loan assistance a loan council, on the pattern of the Australian Loan Council, consisting of the representatives of the Centre, the States, the Reserve Bank and a few financial experts can be set up. Advancement of loans by such a body, instead of the Planning Commission and the central ministries, may go a long way in allaying the apprehensions of the states of being treated discriminately. A fixed percentage of the collection of some of the taxes falling under the divisible pool can be earmarked to be transferred to the States also. Even the base of devolution may be widened "by making one or more central taxes shareable between the centre and the states and in particular assigning a share to the states of the net proceeds of income tax paid by companies (now classified a corporation tax) as also of the net proceeds of a surcharge on income tax levied for a period of more than three years."[105] The study team on Centre-State relations had suggested for appointment of an expert commission to examine among other things the problem of widening the base of devolution. □

[104] S.R. Maheshwari, *op. cit.*, p. 127.

[105] Administrative Reforms Commission, *Report of the Study Team on Centre-State Relations*, Vol. II, September, 1967, p. 2.

Indian Tax Structure—A Brief Review*

P. K. Bhargava

IN ORDER to raise larger revenue resources, the Union and State Governments have tried to collect larger funds through their tax efforts. They have imposed new taxes and have increased the rates of existing ones. In India, we have, thus, been able to increase the percentage of taxes to national income from about 6.6 in 1950-51 to about 14 at present. This achievement, but for certain difficulties, would have been better. It has helped the government to increase the rate of savings and has enabled the government to build up larger revenue surpluses.

We may, however, emphasise here that the State Governments in India are at a disadvantage in tax matters as compared to the Union Government. Firstly, the important indirect taxes of the Union Government, such as union duties of excise, are camouflaged with the price. As a result, the consumers do not know the exact amount they are paying by way of taxes. The indirect taxes of the State Governments, such as the sales tax, are shown separately and the consumer knows it specifically. Hence, the consumer realises their incidence immediately. This invites more resistance from him. Secondly, the direct taxes of the states, such as land revenue and agricultural income tax, impinge directly on the majority of population who play an important role under the right of adult franchise whereas the direct taxes of the Union Government, such as the income tax and corporation tax, affect only those segments of the society which constitute a small political minority. The Union Government has, therefore, found it easy to increase the tax load on these sectors whereas the State Governments have hesitated to tax the agricultural sector.

It is really a peculiar feature of the Indian tax system that an industrialist with an income of over rupees two lakhs gives as much as 97.75 per cent of it to the exchequer while a farmer with the same income keeps a major part of it. It is necessary to emphasize here that the two most important taxes paid by the agriculturists are land revenue and agricultural income tax. However, the fiscal importance of both

*From *Indian Journal of Public Administration*, Vol. XVIII, No. 3, July-September, 1972, pp. 436-42.

these taxes has been declining progressively. Land revenue and agricultural income tax formed 27.9 per cent of the revenue from State taxes in the First Plan. This percentage declined to 26 in the Second Plan, to 18.4 in the Third Plan, and further to 7.1 in 1971-72 (Budget). In 1970-71, the total yield from land revenue and agricultural income tax was Rs. 127 crores, which formed 0.85 per cent of the net output of the agricultural sector. As against this, the income tax collected was estimated at Rs. 460 crores in the same year which formed 2.6 per cent of the net output of the agricultural sector. Between 1960-61 and 1970-71, while the proportion of income and corporation tax to national income from sources other than agriculture has risen from 4.1 per cent to 4.6 per cent, the proportion of land revenue and agricultural income tax to national income derived from agriculture has declined from 1.63 per cent to 0.85 per cent. The green revolution has also improved the relative position of the agriculturists and has introduced new inequities within the agricultural sector.

The separation of agricultural and non-agricultural income for tax purpose is not only a source of tax evasion but also helps in coverting 'black' money into 'white' money. Even if the agricultural income is taxed at as high rates as other income, it is quite advantageous to have the total income divided into two parts under progressive rates taxation. The agriculturists have also benefited from the plan expenditure which is highly agriculture-oriented. Besides, the States have taken steps to provide certain facilities to the agriculturists in the form of cheaper credit, price support schemes, warehousing facilities, etc. It is, therefore, necessary that additional resources should be raised from the agricultural sector to ensure equity in taxation and to accelerate the pace of economic development. However, it is a difficult problem of the Indian tax system as the Union Government is prohibited in the Indian Constitution from taxing agricultural land or income. The structure of federal finance in India has, thus, encouraged the growth of inequities in the Indian fiscal system and some adjustments are called for. It is a happy augury that a Committee, under the chairmanship of Dr. K.N. Raj, has been set up to examine, among other things, the bifurcation of tax jurisdiction between agricultural and non-agricultural incomes.

There is yet another serious flaw in the Indian fiscal system. The richer states do not necessarily have higher per capita tax incidence and disparity exists even among those states whose per capita income is the same. The fifth Finance Commission rightly made the following observation: "The percentages are widely different even among those states with a similar level of *per capita* income. For instance, among the states with higher *per capita* income, while Maharashtra and Punjab raised more than 8 per cent of their incomes as tax revenues,

West Bengal with a similar industrial base as Maharashtra obtained only 6.2 per cent. Among the other four states with *per capita* income above the all-India average, Tamil Nadu raised 7.8 per cent, while Andhra Pradesh and Assam got only a little over 5 per cent." There are wide disparities among states even with regard to per capita incidence of individual taxes. While the per capita income (average for 1962-63 to 1964-65) of Uttar Pradesh was Rs. 306 which was substantially lower than the per capita income of Punjab at Rs. 492, Uttar Pradesh had the highest per capita incidence of land taxes at Rs. 3.03 in 1967-68, and the per capita revenue from taxes on land for Punjab was only Rs. 1.38 in that year. Orissa with the same level of per capita income as that of Uttar Pradesh had only Rs. 0.83 as the per capita revenue from land taxes in that year. This is also true regarding other taxes. For instance, Maharashtra had the highest per capita revenue from general sales tax at Rs. 14.09 in 1967-68 whereas for Punjab it was Rs. 9.34 during the same year while the per capita income of Punjab was Rs. 492 as compared to the per capita income of Maharashtra at Rs. 478. Similarly, Orissa and Uttar Pradesh had the same per capita income at Rs. 306 which was slightly higher than the per capita income of Jammu & Kashmir at Rs. 302; however, the per capita income from general sales tax in 1967-68 for Uttar Pradesh stood at Rs. 4.10 while for Orissa and Jammu & Kashmir it was Rs. 3.69 and 2.57 respectively. These data make abundantly clear that there is some evasion or leakage of revenue in tax system of those states whose per capita income is higher but per capita tax incidence is lower as compared to other states. It is, therefore, necessary that the tax structure of individual states should be thoroughly scrutinized and steps should be taken to exploit effectively the available sources of tax revenue.

Predominance of indirect taxation is another feature of the Indian tax system. There is, however, no dictum regarding the proportion of direct and indirect taxes but in underdeveloped countries, such as India, indirect taxes occupy an important place for a number of reasons. Firstly, the per capita income of people is low, therefore, they do not fall within the net of direct taxes. It may be emphasized here that in India only one in about 450 persons is assessed for income tax, and that income tax assessees form about 0.2 per cent of the population as against about 35 per cent in the UK, and 27 per cent in the USA. Secondly, the cost considerations also prohibit the collection of revenue from poor people through direct taxes. Thirdly, there is less resistance for indirect taxes as they are generally camouflaged in the price of the taxed commodities. For these reasons, we find that the importance of Union duties of excise and sales tax is increasing rapidly.

In the sphere of Union taxes, Union excise duties are the most important source of revenue. The share of Union excise duties in the total tax revenue of the Government of India increased from 16.7 per cent in 1950-51 to 44 per cent in 1971-72 (Budget). During the same period, the revenue from Union excise duties increased by 29.63 per cent, from customs by 240 per cent, from income tax by 269 per cent and from all taxes by 665 per cent. These data clearly indicate the growing importance of Union excise duties in the tax structure of the Government of India and suggest that in future they will continue to be an important source of revenue.

In the tax structure of the State Governments, sales tax is the most important source of revenue. The share of sales tax in the total revenue from State taxes increased from 26.9 per cent in 1950-51 to 50.2 per cent in 1971-72 (Budget). On the other hand, the share of land revenue declined from 22.5 per cent to 6.3 per cent. During this period revenue from sales tax increased by 1,245 per cent. from land revenue by 102 per cent, from agricultural income tax by 160 per cent, from stamp duties and registration charges by 400 per cent and from all taxes by 621 per cent. These data demonstrate the elastic nature and predominance of sales tax in the sphere of state taxation. These data also indicate the states' reluctance for further extension of the scheme of additional duties of excise for sales tax.

Incentive taxation is an essential feature of the Indian fiscal system. Various incentives have been incorporated in the Indian tax structure to encourage savings, investments and exports, etc. Individuals and Hindu undivided families get substantial relief, up to certain specified limit, in the form of contributions to government and recognized provident funds, cumulative time deposits in Post Offices and life insurance premium. The Union budget for 1970-71 provided that income from interest on the Units of the Unit Trust of India and that from dividend on shares and debentures of Indian Companies up to Rs. 3,000 will be exempted from income tax from the assessment year 1971-72. Formerly, this limit was Rs. 2,000. The Indian tax structure incorporates some other tax incentives also to encourage saving and investment. For instance, in December 1964, the Union Finance Minister announced a scheme of tax-free tax credit certificates; the scheme was, however, abolished with effect from April 1, 1970. The Union Government has instituted a scheme of Public Provident Fund, under the Provident Fund Act 1968, with a view to mobilizing personal savings and providing an opportunity for long-term savings to all sections of the society, especially the self-employed persons. The budget proposals for 1963-64 included a compulsory scheme (also known as Compulsory Deposit Scheme) with the object of increasing resources of the government and imposing additional saving on all

sectors of the economy. This scheme was abandoned in 1964-65 when it was substituted by the Annuity Deposit Scheme. The Finance Act, 1968, abolished the Annuity Deposit Scheme as it involved a lot of administrative work. We may emphasize here that these instances show how hastily the changes are made in our tax structure which introduce instability in the tax system, which is beneficial neither to the government nor to the tax payers. Moreover, in the absence of availability of adequate data, it is very difficult to say if the incentives incorporated in the Indian tax structure have really helped in creating substantial savings in the economy because these incentives have benefited mostly the people in larger income brackets, who have used these tax relief measures to reduce their tax liability. We think that this is a field for further investigations for the fiscal theorists and requires some more researches to be done to arrive at a definite conclusion.

Industrial undertakings are also given certain tax incentives in the form of tax holiday and development rebate. Beside these, the companies that produce or manufacture any of the articles specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, benefit from the tax credit certificates schemes. Industrial undertakings that employ displaced persons from Pakistan or repatriates from Ceylon, Burma and Mozambique or any other foreign country are given tax concessions. Industrial undertakings benefit from some other tax concessions also. It may be emphasized here that the government has given these tax incentive concessions to the corporate sector to promote industrial development of the country. However, the real purpose is not achieved by these as the tax incidence on the corporate sector is very high in our country. The maximum corporate tax rates in India are higher than even some of the advanced countries of the world. While in India, the maximum statutory tax rates on companies vary between 60 per cent to 75 per cent (including surtax), the maximum tax rates on companies are 12.5 per cent in Hong Kong; 18.7 per cent in the United Arab Republic; 20 per cent in Turkey; 25 per cent in Korea, Laos and Thailand; 50 per cent in Canada, France, New Zealand, Pakistan and Kuwait, 52 per cent in Austria; and 54 per cent in the UK. We may also emphasize here that the Indian corporation tax is progressive and this progressiveness exists because of the sur-tax which is charged on the 'excessive' profits of the companies.

The Government appears to have realized this fact and it was, perhaps, for this reason that the corporate sector was kept outside the tax net in the Union Budget for 1970-71. However, the Union Finance Minister, in the budget for 1971-72, withdrew some of the concessions adversely affecting the corporate sector. In my opinion the blanket withdrawal of development rebate on new plants and machinery installed after May 31 1974 and the narrowing down of the list of priority

industries together with reduction in their tax-free profits was a hasty measure as it will reduce resources available for industrial expansion and would give a serious setback to industrial growth of the country. The development rebate had helped substantially the industrial development of the country and it took care, at least partially, of appreciation in the cost of plant and machinery for the purpose of replacement, rehabilitation and modernization. In view of the progress already achieved in the industrial sphere, we think that instead of giving development rebate to all industries, this facility should be given on a selective basis to industries that are essential for economic growth or which help to increase exports or encourage import substitution. The Planning Commission should conduct research in this direction on a regular basis and advise the government from time to time. However, it may be emphasized here that it is in the broader national interest that the structure of corporate taxation should be geared to accelerate capital formation and industrialization of the country.

One of the most serious lacunae of the Indian fiscal system is that *ad hoc* changes are made in the tax structure almost every year and a number of these changes have been made with remarkable rapidity. The annual Finance Act, which incorporates the various changes in the existing tax structure, usually runs into 70 or 80 pages, and the knowledge of tax laws becomes obsolete pretty soon. It is unfortunate that tax rates are changed very frequently and every year the Finance Minister considers it almost necessary to make some changes in the tax structure. New taxes are imposed and they are abolished/replaced after a short time. For instance, the budget proposals for 1963-64 included a compulsory scheme (also known as the Compulsory Deposit Scheme) but it was abandoned in 1964-65 when it was substituted by the Annuity Deposit Scheme. The Finance Act, 1968, abolished the Annuity Deposit Scheme. The expenditure tax was imposed from 1957-58 but was abolished with effect from April 1, 1962, and was revived again from the assessment year 1964-65. The Expenditure Tax Act, 1957, was, however, abolished with effect from April 1, 1966. This is also true regarding the State Taxation. The State Governments have also hastily imposed and abolished the taxes. For instance, the Government of Uttar Pradesh introduced the profession tax from April 1, 1966, but abolished it with effect from April 1, 1971. These instances show the hasty decisions of the Union and State Governments regarding tax matters. Shri Bhoothalingam rightly observed that, "More often than not new taxes or other types of fiscal changes are introduced to subserve the needs of the moment and are grafted on to the existing body without enough regard for compatibility or consistency." It may be emphasized here that instability in the tax rates and frequent changes in tax structure create uncertainty in the minds of tax payers,

savers and investors. It causes undesirable fluctuations in levels of income and unemployment. It is, therefore, suggested that tax structure and tax rates should be kept stable (at least for a period of five years) after ensuring revenue elasticity so that the tax revenue increases automatically with the generation of additional income. A stable tax structure is also necessary to encourage increase in savings and investments in a developing economy and to ensure wise planning of private investment.

The structure of federal finance in India has encouraged the growth of new inequities in the Indian fiscal system. The government has found it easy to increase the tax burden on direct tax payers who are a political minority. It may be emphasized here that marginal tax rates in our country are perhaps the highest in the world and cover relatively lower levels of income. The present marginal rate of income tax on slabs exceeding Rs. 2 lakhs is as high as 97.75 per cent (including a 15 per cent Union surcharge on basic rate of income tax). Against this, the maximum marginal rate of personal income tax is only 45 per cent in France (on earned income), 53 per cent in Germany, 65 per cent in Sweden and 70 per cent in the USA and Pakistan. It may be mentioned here that the government does not have the administrative competence to enforce these high rates (except on the honest tax payers). Such high rates of taxation have not only excouraged tax evasion but have introduced inequity in the burden of taxation between honest and dishonest tax payers. These high rates of taxation have tended to narrow the gap between honest tax payers and less well-to-do sections of the society but have widened the gap between dishonest tax payers and less well-to-do sections of the society. These high rates have also diverted funds from productive investment to conspicuous consumption and have encouraged black-marketing, corruption and bribery. □

Social Objectives and Tax Policy in India*

M.J.K. Thavaraj

ECONOMIC DEVELOPMENT and social change involve quantitative and qualitative changes in the scale and pattern of the infrastructures created as well as the operation of directly productive activities alongwith radical reorganization of the attitudinal, organizational and institutional patterns prevailing in the developing countries. This is particularly true of ex-colonial countries like India characterised by feudal and semi-feudal relations on land, outmoded systems of social organization, lopsided and enclave type of industrial development, dominance of foreign capital in the leading sectors of the economy, concentration in the ownerships of commercial and industrial property, structural and regional imbalances, social and economic inequalities and so on. Scrapping of the outmoded institutions, organizations and practices, modification of the attitudes and patterns of behaviour, creation of new institutions, relationships and organizations are, therefore, regarded as prerequisites for rapid economic development and social justice.

In general, the constitutional and legal framework relating to property relations and social structure, size and pattern of investment, structure of production, contractual payments, education and social services as well as fiscal measures are regarded as the instruments of economic development on the one hand and reduction of socio-economic imbalances and disparities arising from the process of income-generation, in the accrual of private and personal incomes and in the standards of consumption on the other. Only a concerted effort having recourse to all these instrumentalities would have facilitated the realisation of the stated goals and objectives. Unfortunately, the first 25 years of Indian Independence have been characterised by a lack of clarity in purpose and half-hearted and mixed up institutional and organizational changes which have rendered tax efforts somewhat ineffective and tax administration difficult.

Conflict of Purposes

The Constitution of India has enshrined private ownership of pro-

*From *Indian Journal of Public Administration*, Vol. XVIII, No. 3, July-September, 1972, pp, 381-94.

perty as a fundamental right and has relegated: (1) an equitable distribution of ownership and control of the national resources of the community; and (2) the prevention of concentration of wealth and means of production resulting from the operation of the economic system, to the Directive Principles of State Policy. The institutional reforms attempted so far are meant to strengthen private property in land and business. The growth of public sector is largely meant to supplement and subserve private sector. Leaving the commanding heights of the directly productive and profit yielding economic activities in private hands accounts for the basic contradictions between the twin objectives of increased production and reduction of inequalities. Even the Plan documents where the social objectives are strongly emphasised, consideration of 'increased production' has invariably exerted the deciding influence. While, on the one hand, the First Plan recognized the efficacy of fiscal measures such as death duties, graduated income tax and so on as important equalisers, on the other, emphasised the need for balancing the advantage of greater equality of incomes against the disadvantages of a possible fall in private savings and capital formation and general discouragement of productive activities. Taxation of the rich was to be stepped up only when alternative sources of savings and agencies for capital formations are developed.[1] Similarly, even while the Avadi Resolution was still filling the air, the Second Plan sounded a note of warning that "it is important to ensure that in reducing inequalities no damage occurs to the productive system as would jeopardise the task of development itself."[2] The Planners realised the importance of fiscal measures in reducing inequality in income and wealth. At the same time, they played down the scope of progressive direct taxes on the ground that "the marginal rate and taxation on incomes in higher brackets have already been satisfied". It was feared that progressive fiscal measures would adversely affect the incentive to work and save besides "creating other difficulties".[3] The Third Plan, which marked a retreat from the earlier egalitarian professions, redefined progress towards socialism in terms of "efficiency, progressive approach to science and technology and steady rate of growth"[4]. Consequently fiscal policy was relegated to the background. Similarly, the Fourth Five Year Plan has placed greater reliance on "positive steps for ameliorating the conditions of poorer people through planned economic development", and "the regulation and control over monopolies to pre-

[1]*First Five Year Plan*, People's Edition, Planning Commission, Government of India, 1953, pp. 11, 12, 17 and 18.

[2]*Second Five Year Plan*, Planning Commission, Government of India, 1956, p. 33.

[3]*Ibid*., p. 34

[4]*Third Five Year Plan*, Planning Commission, Government of India, 1962, p. 9.

vent concentration of economic power".[5] Thus, it is obvious that their anxiety for rapid economic development, the Indian planners were inclined to tone down the equalising role of fiscal policy under the Plans.

Even this limited social concern is not reflected in the official pronouncements of the various Finance Ministers. Following the recommendation of the Taxation Enquiry Commission, the primary preoccupation of the Government was to raise the proportion of taxes to national income and induce saving and investment. Accordingly, in his budget speech of 1957, T.T. Krishnamachari, enumerated mobilization of additional resources, provision of incentives to saving, restraint on consumption and improved tax administration as the objectives of tax policy of the Government of India. In this scheme of resource mobilization, if relief was given it was only for producers, savers and investors and not to the consumers. Later, in 1968, Morarji Desai offered some relief to exporters "to propitiate the gods of international competition". Reduction of inequalities in income and wealth or deconcentration of economic power never figured in fiscal policy pronouncements. Nor did they get reflected in the system of taxation or tax administration that have been in operation.

Constraints on Tax Effort[6]

Indian type of mixed economy, where the profitable lines of economic activities are largely left in private hands, mobilization of resources is beset with severe constraints and limitations. First of all, the role of the state as a promoter and underwriter comes into conflict with that of a mobilizer. Often the loss sustained by electricity undertakings and other utilities and infrastructure facilities is largely attributable to the promotional efforts of the government especially at the state level. The shortfalls in such non-tax revenues are generally a burden on the general tax payer.

Curb on Consumption

Tax effort under the Plans has largely been hitting the poorer consumers more than any other class. One can cite the highly graduated personal income tax or higher rates of commodity taxes on luxury consumption as evidence of progressiveness in taxation. Land revenue has remained as regressive as ever despite weak attempts to impose surcharges on larger landholders. The local and municipal taxes and rates are basically regressive in character. Shorn of the frills, sales

[5]*Fourth Five Year Plan*, Planning Commission, Government of India, 1969, pp. 15 and 27.

[6]For an elaborate treatment of the problem refer to the author's article on "Constraints on Resource Mobilisation", *Social Scientist*, Vol. I, No. 1, August, 1972, pp. 12-29.

taxes in India are directed against the poorer and middle income brackets who constitute the mass of the consumers. The bulk of Central and State excise is also raised from commodities of mass consumption. The sheltered market enjoyed by the Indian industries is largely at the expense of the general consumers. In a sellers market free from price controls company taxation could easily be shifted to the consumers through higher prices. Agricultural income-tax is still a spec in the ocean. Against this background of regressivity of most of the Central, State and local taxation, graduated income-tax hardly makes much of a difference to the overall character of the tax system in India.

Though it is recognized that all direct taxes do not rest on the rich and some indirect taxes are aimed at the rich consumers, it is customary to classify taxes in terms of direct and indirect to assess, in broad terms, who bears the brunt of the tax burden. Looked at this way, the basic tax statistics in India highlight the increasing reliance on indirect taxation affecting commodities of mass consumption both at the Central and the State levels. For instance, taxes collected through customs, Union excise and sales did not exceed Rs. 250 crores in 1950-51. The corresponding figure in the budget estimates for 1972-73 is around Rs. 3,650 crores. This, of course, is exclusive of some of the prominent indirect taxes from state excise, motor vehicles, passenger and goods, entertainment and so on. On the other hand, direct taxes which affect the wealth and income (including that of corporation tax) of the rich has increased from Rs. 150 crores in 1950-51 to a little over Rs. 1,200 crores in 1972-73. If we compare personal income-tax with union excise, it would be obvious that, whereas income-tax has not increased by more than 10 times, central excise has gone up by about 50 times over the period 1948-49 to 1972-73. The poor performance of property taxes becomes so glaring when viewed against the phenomenal increase in the net worth of private property. For instance, the net worth of privately owned corporate property is around Rs. 6,000 crores. Taxes falling on such property by way of wealth-tax, capital gains tax and gift-tax all put together amount to much less than Rs. 50 crores, today, (some of these taxes affect non-industrial property also).

It must also be noted that, more recently, the proportion between direct and indirect taxes has changed quite sharply in favour of indirect taxation. Whereas the revised figures of the Central budget for 1971-72 show a ratio of 2:5 between direct and indirect taxes, the corresponding ratio for the additional taxes proposed in 1972-73 budget shows a steep rise to 1:10. In fact, every national emergency has been accompanied by sharp increase in indirect taxation affecting the masses of the consumer.

Inflationary Financing

Though deficit financing is not taxation, in effect, it is an instrument for curbing consumption and augmenting profit. In fact, in the context of an inflationary gap generated by the process of development, deficit financing erodes real incomes of those whose incomes are sticky or lag behind prices and makes mercantile and industrial capital more profitable. Insofar as it is politically more expedient, the Government of India has had liberal recourse to it as part of its general strategy of transferring resources from the general consumers to the saving classes. Though the Neo-Keynesians, who have been influencing the monetary and fiscal policies in India under the Plans, have favoured just a mildly inflationary policy of 2-3 per cent rise in price level per annum, governments addicted to deficit financing are tempted to excessive indulgence especially when confronted with strait financial circumstances. In fact, during the last decade, the government has invariably overshot the targets for deficit financing even though there have been serious shortfalls in the production programmes and conditions of supply. For instance, since the end of the Second Plan, the growth of per capita real income was never even half as much as was planned. But the actual quantum of deficit financing in the Third Plan was more than twice as large as was envisaged. This trend has been further aggravated in recent years. Consequently, prices have more than doubled since 1961. As a result, speculative traders, oligapolistic and monopolistic producers and landlords controlling the bulk of the marketed surplus from agriculture have enriched themselves at the expense of the working class, landless poor and fixed income groups.

Inducement to Save and Invest[7]

Apart from reaping the advantages of a sheltered market and aggressive demand, the investors and producers in India enjoy enormous benefits by way of tax concessions and subsidies. The Indian Income-Tax Act offers a wide range of tax incentives for the development of industries, for improving agricultural productivity, for promoting exports, for stimulating savings in the household sector and for encouraging foreign investment in the country. New industrial enterprises, hotels and ships are normally allowed a five-year tax holiday. Unabsorbed benefit of tax holiday is allowed to be carried forward up to eight years from the commencement of the business. Dividend declared by new industrial undertakings are also entitled to tax holiday. Even when the holiday expires one is entitled to a tax free dividend of Rs. 3,000 p.m. Lower rates are allowed on companies engaged in

[7]For a detailed list of fiscal incentives, refer to India, *Pocket Book of Economic Information*, Ministry of Finance, Government of India, 1970, pp. 297-323.

priority industries or employing mainly displaced persons or repatriates. Inter-cooperate dividends are also given tax concessions.

Besides, Development Rebate (DR) constitutes an important stimulant investment in new machinery or plant installed in a broad spectrum industries. A rough estimate of DR available to the private corporate sector would be around Rs. 70—Rs. 80 crores a year at present. This implies an annual tax savings of about Rs. 40 to Rs. 45 crores which constitutes about 10 per cent of the amount collected under corporation tax.[8] Shipping industry which enjoys a higher rebate is said to have paid only Rs. 2 crores in the last 10 years as against Rs. 50 crores it would have paid in the absence of DR.[9] Apart from DR, Development Allowance of 30 per cent of cost of replanting is allowed to the tea industry. Export-oriented industries are also given additional concessions. The depreciation allowances allow for an accelerated recovery of the initial cost of investment. In addition, investors are allowed concessions on account of capital expenditure on research, transmission of technical know-how, amortisation of preliminary expenses, expenditure on shifting of industrial undertakings, expenditure on prospecting, amortisation of cost of patent rights, copyrights and so on. It is estimated that, if these concessions (including the tax credits still available on increased production, exports and so on) are withdrawn, the revenue would jump up by Rs. 185 crores[10], *i.e.*, about 38 per cent. These concessions are in addition to the concessional rates at which land power, water and other facilities are extended by the various state governments to private business.

DR and other tax concessions and credits were meant to induce investment through: (*a*) reduction in risk by enabling an early write off cost of capital assets; (*b*) reduction in effective rate of tax; and (*c*) augmentation of internal resources. Early recovery of capital cost before the expiry of the full useful life of assets enables the investor to earn an extra return on the prematurely realised capital cost by ploughing it back into the business. Exemptions and concessions reduce the effective rate of tax on corporate income to around 43 per cent while the nominal rate happens to be 57.5 per cent. Many a spokesmen of the corporations raise a hue and cry about higher costs of replacement of wasting assets due to rising prices, but, available studies seem to indicate that internal resources account for more than 85 per cent of

[8]Paper presented by N.J. Jhaveri at the Seminar on Company Taxation organised by the Institute for Financial Management and Research, Madras during September 29-30, 1972.

[9]Paper presented by P.K, Doshi at the Seminar on Company Taxation organised by the Institute for Financial Management and Research, Madras, during September 29-30, 1972.

[10]*Ibid.*

the expansion and replacement of gross outlays on fixed assets in the private corporate sector. In fact, internal resources were found to exceed the requirement of gross fixed capital assets (including expansion) in the year 1970.[11]

Tax inducements outlined above have often led to certain distortions in the allocation of scarce capital resources. Development Rebate is not deducted in computing the written down value of the assets for the purpose of calculating depreciation and extra shift allowances. Accordingly, total amount deductible over the life of a depreciable asset which qualifies for development rebate is more than 100 per cent of the cost; for example, in the case of ships, it is 140 per cent.[12] Such a liberal treatment has induced investment in low profit industries. According to S. Bhoothalingam such inducement is wasteful in a capital scarce economy.[13] Secondly, It is possible that, reduction of the private cost of fixed capital might have encouraged choice of capital-intensive processes of production and resulted in somewhat higher installation of capacity than what would have been in its absence. Thus DR might have been one of the factors responsible for the phenomenon of under utilisation of capacity. The cleverer ones amongst them might have also claimed tax credits for increased production by utilising the excess capacity created under the stimulus of DR.

It is often the well established big business which reaps most of the benefits of tax inducement. It is they who dominate the priority industries; enjoy the facilities for export-oriented activities: secure the best of the licences; pre-empt capacities; influence decisions regarding fiscal inducements and so on. It is the influential business houses who are in a position to extract favourable terms for the services, utilities and prices from the different levels of government. Consequently, fiscal inducements tend to aggravate inequalities within the corporate sector while at the same time transferring resources from the rest of the economy to the corporate sector. IFC, ICICI, IDB, LIC, Commercial Banks and other financial institutions have been the main channels through which such transfers take place outside the fiscal apparatus.[14] These transfers may be 'developmental' but, are by no means 'egalitarian'.

The Development Rebate was conceived of by the Taxation Enquiry

[11]N.J. Jhaveri, *op. cit.*

[12]India, *Pocket Book of Economic Information*, 1970, *op. cit.*, p. 300.

[13]S. Bhoothalingam, "Final Report on Rationalisation and Simplification of the Tax Structure", 1968.

[14]Report of the Committee—*Distribution of Income and Levels of Living*, Part 1, Government of India, Planning Commission, 1964, p. 47; R.K. Hazari, *Final Report on Industrial Planning and Licencing Policy*, 1966, pp. 22 and 26, Industrial Licencing Policy Enquiry Committee Report, 1969, ch. 7.

Committee as an incentive measure for promoting fixed investment in selected industries.[15] But when DR was introduced in India in 1955 it was in respect of new Investment in plant and machinery for business purposes in all industries. Initially, the rate of DR was 25 per cent; though, in subsequent years, differentially higher rates were introduced for investment in priority industries though about 33 industries were declared as priority industries for purposes of DR as per Fifth Schedule to the Income-Tax Act of 1961. Another 28 industries were listed in the Sixth Schedule as priority industries for concessional rate of corporation tax. By ignoring the selectivity principle the DR had become a handy device to reduce the effective rate of corporate taxation. In fact, the foreign exchange crisis of 1958, the national emergencies of 1962, 1965, 1971 and the stagnation of the economy since the Third Plan, have all been accompanied by fresh crops of incentives and tax concessions. That is why the Government of India has announced the withdrawal of the Development Rebate from June 1, 1974[16] on the recommendation of the Wanchoo Committee. But, at the same time, the Wanchoo Committee recommended a sharp scaling down of marginal rates of personal income tax from 97.75 per cent to 75 per cent and recommended a few fiscal inducements for selected industries on the ground of labour orientation, development of backward areas, and additional productivity[17] and so on which might as well open the floodgates of new sets of incentives and rebates.

It is doubtful whether these incentives recommended by the Wanchoo Committee are well conceived. When the package of industrial development has several inherently capital intensive industries such labour-oriented incentives are likely to distort the projected pattern of industrial development and deflect resources into less important industries. As for inducing industries into backward regions, the locational disadvantages might outweigh tax incentives. Large dosages of incentives, powerful enough to overcome the cost disadvantages of backward regions, might be grabbed by the most influential amongst the big business houses and tighten their grip over the backward regions and the state governments and agencies engaged in the development of the backward regions.

Tax Evasion and Avoidance

Ever since World War II there has been a cumulative increase in 'black money' which has given rise to a huge 'parallel economy'

[15] *Report of the Taxation Enquiry Commission*, 1953-54, Government of India, Vol. I, p. 155.

[16] *Direct Taxes Enquiry Committee, Final Report*, Government of India, December 1971, p. 113.

[17] *Ibid.*, paras 5.74, 5.70 and 5.80.

in India today. Though all black money does not originate in tax evasion, all tax-evaded income represents black money.[18] In 1954-55 Nicholas Kaldor placed the income-tax lost through tax evasion at Rs. 200-300 crores.[19] The Wanchoo Committee estimated the tax loss in 1968-69 to be Rs. 470 crores.[20] It is interesting to note that evaded income-tax is larger than what was collected in that year. Similarly leakages in foreign exchange seem to account for Rs. 240 crores which is nearly one-fourth of our exports.[21] The Wanchoo Committee has listed the following as causes of tax evasion:

(a) high rates of taxation under the tax laws;
(b) economy of shortages and consequent contents and licences:
(c) donations to political parties;
(d) corrupt business practices;
(e) ceilings on and disallowance of business expenses;
(f) high rates of sales-tax and other levies;
(g) ineffective enforcement of tax laws; and
(h) deterioration in moral standards.[22]

Normally the remedial measures flow from the analysis of the causal factors. The Committee thought that the best way of reducing the temptation to evade is to scale down the marginal rate of income-tax (including sur-charges) from 97.75 per cent to 75 per cent as if the temptation could be any less at the reduced rate. The immediate revenue loss was placed at Rs. 40 crores though it hoped that it would be offset in due course through better compliance and increased saving and investment.[23] The Committee was in favour of liberal allowances for business expenses by way of entertainment and maintenance of guest houses for temporary stay.[24]

The Committee has ceıtainly applied its mind in favour of tightening the penal provisions and a more vigorous prosecution and enforcement. To a large extent, the effectiveness of implementation of these measures would depend on the extent to which donations to political parties could be regulated. It is understood that no worthwhile tax

[18]*Direct Taxes Enquiry Committee*, Final Report, *op cit*., p. 4.

[19]Nicholas Kaldor, "Indian Tax Reforms, Report of a Survey", Ministry of Finance, Government of India, 1956, p. 105.

[20]*Direct Taxes Enquiry Committee*, Final Report, *op. cit*., p. 8.

[21]The Report of the Study Team on Leakage of Foreign Exchange through Invoice, Manipulation, Government of India, 1971. The actual amount is estimated to be around Rs. 450-500 crores per annum. See *Economic and Political Weekly*, July 22 1972, p. 1407.

[22]*Direct Taxes Enquiry Committee*, Final Report, *op. cit*., pp. 167-68.

[23]*Ibid*., p. 20.

[24]*Ibid*., pp. 23.24.

reform could ever be enforced without really snapping the link between black money and the corrupt political and bureaucratic elements. But, as is now obvious, the government is in no mood to stop donations to political parties.

Tax avoidance takes place by availing the tax exemptions or tax privileges offered by the government or by manoeuvres involving an element of deceit, misrepresentation of facts, falcification of accounts, including downright fraud. The first represents what is truly 'tax planning', the latter tax evasion.[25] Taking advantage of the looseness in the concept of income and the confusions caused by institutions like the Hindu Undivided Family, partnership arrangements, charitable and religious trusts, treatment of expenses and so on, quite a good deal of income escapes the tax net. In fact, the technicians who design the tax laws seem to leave enough loopholes to be exploited by the army of professional accountants and tax lawyers at the service of the private tax avoider. For instance, wealth tax which apparently exempts only wealth up to Rs. 1 lakh, in fact, requires a person with 11 lakh wealth to pay only about Rs. 1,600 by way of wealth-tax if he carefully exploits all the loopholes left open.[26] According to Krishnan, properly tapped, even with nominal rates varying from 0.5 per cent to 5 per cent such a tax should yield about Rs. 220 crores to Rs. 350 crores per annum. Compared to this great potential the present yield of about Rs. 15 crores looks so ridiculously low. In fact, as seen earlier, all the imposts borne by non-agricultural property and wealth such as wealth-tax, capital gains tax and gift tax put together do not exceed Rs. 50 crores per annum. It follows that in view of widespread evasion and avoidance, the effective tax rate on companies are far lower than the formal rates especially in the case of dishonest tax-payers.

The Wanchoo Committee has put its finger at the right place when it accused agricultural income as offering plenty of scope for camouflaging black money. As pointed out by the Committee, in recent years, agricultural farms, vineyards and orchards have been acquired by many film artists, industrialists and others, not for the love of agriculture but to convert their black money into 'white money'. Often, when tax payers are confronted with the need to explain certain deposits, investments or expenses, they attribute them to agricultural income. In fact, tax burden on the urban income is relatively so high that a tax payer having urban income of Rs. 10 lakhs is left after paying income-tax with almost as much income as another person having an agricultural income of Rs. 1 lakh only. The Committee has emphasised that there is no justifiable reason for this vast disparity

[25] *Direct Taxes Enquiry Committee*, Final Report, *op. cit.*, p. 183.

[26] T.N. Krishnan, "Taxation of Property and Net Wealth In India—A Note", *Economic and Political Weekly*, pp. 21-41.

between the tax burden on the two sectors, particularly when, as a result of the 'green revolution' and the price-support policy of the government, income from agricultural holdings has been progressively rising in recent years.[27] The Wanchoo Committee had also underlined the close link between evasion of income-tax and evasion of sales-tax.[28] But, in their effort to block the escape routes of evading income, the Committee seems to have hastily recommended the handling of agricultural income tax by the Centre and substituting central excise duty for sales tax without, in the least, bothering about the debilitating effect they would have on the already weak finances of the States.

The Wanchoo Committee placed the gross tax arrears at Rs. 840.70 crores as on March 31, 1970. The net effective arrears on the same date is, however, estimated to be Rs. 591.18 crores only.[29] Administrative delays, hurried and half-baked assessments, cumbersome procedures for appeal and disposals have all contributed to the accumulation of arrears over the years. Often, large firms equipped with expert legal advisers are the ones who profit by the dilatory processes of tax administration and discretionary powers enjoyed by the various levels of tax officers. The findings of the various Commissions of Enquiry into the affairs of some of the big business houses have revealed how evasion, avoidance and corrupt practices have been exploited by unscrupulous businessmen and their professional hirelings to minimise their effective burden of taxation. Therefore, as an overview, one could maintain that, whereas the taxes aimed at the poor hit them much harder than it meets the eyes, the overall burden on the rich has been much lighter than it appears on the surface. These realities have undermined the efficacy of taxation as an instrument of levelling inequalities in income and wealth in India.

CONCLUSIONS

In a fundamental sense, it is the private ownership of the profitable lines of directly productive activities in agriculture, trade and industry which account for the inequity of the tax system and alarming leakages in revenue. A forthright remedy would have been the socialization of the means of production, exchange and distribution. When such straightforward course of action is found impracticable on pragmatic political grounds, fiscal policy as an integral part of the economic policy which aims at increased production alongwith reduced inequalities in income and wealth is bound to flounder against the logic of private property. At the policy level, therefore, the objective of rapid economic

[27] *Direct Taxes Enquiry Committee*, Final Report, *op. cit.*, pp. 40-41.
[28] *Ibid.*, p. 43.
[29] *Ibid.*, pp. 88-89.

development through induced savings and investment gains dominance over the realisation of the egalitarian objectives through improved distribution and net fiscal transfers.

In practice, even rapid development envisaged within the framework of mixed economy is severely constrained on account of : *(a)* the loss of revenue involved in fiscal inducements; *(b)* the loss of real resources (both foreign exchange and scarce domestic resources) absorbed by the U-sector activities meant to meet the needs of property owners for incentive goods; and *(c)* leakages and seepages of revenue through tax evasion, tax avoidance and laxity in tax administration.

Once granted, incentives tend to perpetuate themselves in some form or other. For instance, protective tariffs have often been justified on the basis of infant industry arguments. But in practice, the 'infants' never give up their bottle feed! Similarly, the forms of fiscal inducements change from time to time. But, those addicted to them will always clamour for new and more potent stimuli. The experience of tax inducements in India has vindicated this tendency. The Development Rebate, for instance, was conceived of as a fiscal inducement on a *selective* basis. When it was given concrete expression selectivity was forgotten in favour of *all inclusive* applications. Then it was found expedient to evolve differential rebates and allowances in favour of *priority* industries. But, though national and plan priorities change from time to time, there was no corresponding weeding out of industries from the priority list. Instead, the list generally gets elongated over a period of time to the effect that specificity and selectivity lose all meaning. Even the Wanchoo Committee recommendations or the action taken thereon by the government only tend to introduce new types of inducements in the place of old. Besides, it is these incentives, allowances and exemptions which provide the necessary loopholes for tax avoidance. In fact, corruption breeds behind the discretionary powers enjoyed by tax administration while interpreting the various elements of inducements and exemptions in concrete cases. One way of plugging the loopholes and sealing the leakages is by eliminating all the elements of inducements in the tax laws and in presenting them as direct subsidies on the expenditure side of the budget in conformity with the shifting priorities of the government. Apart from simplicity, this scheme would be relatively free from loopholes and areas of discretion.

Putting an end to the frittering away of scarce resources in conspicuous U-sector consumption would require vigorous controls at different points of decision-making such as allocation of investible funds and other scarce material, control over production, distribution and prices. In a way, these would test the strength of planning against the pressures of the market. In countries like India, where the market forces become

increasingly dominant diverting the resources away from conspicuous consumption is almost impossible. For the same reasons, and for want of suitable organization, the abundant surplus manpower in India remains unutilised.

Wanchoo Committee has devoted a lot of attention towards the refinement of the tax laws, gearing up of the enforcement machinery and improvement of tax administration. But the trouble is that administration does not function in a vacuum. It is a part and parcel of the total politico-economic environment. The ownership structure causes enormous income to accumulate in private hands. This power of property and income extends far beyond the confines of normal business. Apart from conspicuous display of their affluence, the rich are in a position to finance the political parties and loading political elements at various levels. The influence and support gained in this process is the best guarantee against basically hostile economic environment and policies. Even if an administrator were inclined to remain neutral and objective, it would be extremely uncomfortable to disregard the community of interest that emerges between the political and economic interests. More often than not they succumb to the temptations and pressures arising from the environment. That is how the tax laws and their enforcement are found to be so inadequate in dealing with tax delinquency, leave alone enforcement of equity and social justice. The situation is far less cheerful at the cutting edge of tax administration. It would be too much to expect honesty and integrity from the persons who man a sales-tax pool, or a sales tax or income tax office at lower levels when the whole atmosphere is vitiated by political and other forms of corruptions at high places. That is why the taxation in India has, so far been unable to tap the resource potential reduce inequalities in income and wealth and effectively overcome the black money which continues to haunt and harass the Indian economy. □

Taxation Policy and Tax Administrative Problems*

Asok Chanda

WHEN WE talk of tax burden or tax relief, we have the incidence of income tax in mind. Taxation has, thus, tended to become synonymous with income tax. Is it because of semantics, the other central levies being dubbed 'duties', that it is so or is it because it touches the pockets of the influential section of the community, namely, the industrialists, businessmen, professionals and the salaried classes? Yet, only 30,12,570 individuals, in a population of 548 millions, pay income tax and its yield is not comparable to the contribution excise duties make to the central fisc.

Because of the impact of evasion of income tax on price level and economic conditions in general, government also attaches greater importance to this levy than to others. Though excise duties are the mainstay of the Centre today, there has only been one independent review of its structure and administration in 1963 by the Central Excise Reorganisation Committee, of which I was the Chairman. A similar study of customs duty was undertaken in 1958-59 by a committee headed by Shri Badhwar, one-time Chairman of the Railway Board. On the other hand, there have been as many as seven studies in depth into the structure of income tax and the social and economic offences of evasion in a span of 24 years. Shortly after Independence the Income Tax Investigation Commission was constituted in 1948. It was followed in quick succession by the Taxation Inquiry Commission in 1953-54; a review by Nicholas Kaldor in 1956, the Tyagi Committee in 1958-59, a study by Shri Bhoothalingam in 1967, the working group, headed by Shri Tyagi, appointed by the Administrative Reforms Commission and the report of the Commission thereon, and finally by the Wanchoo Committee which has just reported. Though the terms of reference of the committees were somewhat different, they covered, more or less, the same ground.

In the last ten years, the Income Tax Act has been amended 24 times incorporating over 800 amendments. While the Income Tax Act, 1922, had 68 sections, the Act had in 1961 as many as 298 sections and

*From *Indian Journal of Public Administration*, Vol. XVIII, No. 3, July-September, 1972, pp. 341-50.

the process of elaboration continues. Yet, we are told that the levy of the tax is being progressively simplified. Be as it may, none would dispute that there should be n measure of stability in the provisions for the levy of income tax and corporation tax. This would help the corporate sector in planning its modernization and expansion programmes on a long-term basis; it would equally help the individual to assess his commitments over a longer period than a year and organize his financial affairs accordingly. Just as the socio-economic growth of the country is planned for five years at a time, so must taxation policy and the objectives it seeks to fulfil be planned on a five-year basis to stimulate investments and accelerate industrial development.

There is also the need for reviewing fiscal levies as a connected whole, assessing their interaction and providing for their integration to the extent feasible.

Agricultural Income Tax

Such a review must necessarily take into account the taxation of the rural sector, which accounts for about half the national income. Though largely for historical reasons, agricultural income tax was placed in the State List in the division of power in our Constitution, it cannot obviously be left out in a comprehensive review of tax levies. But the spacious argument may again be put forward that the agriculturist pays a land revenue, why should he be subjected to a further impost? Because of their inter-relationship, which is often exploited, it is necessary to make a brief reference to land revenue. The importance of land revenue, which was the backbone of Indian finance sustaining both the central and provincial governments at one time, has dwindled over the years mainly for political reasons. No political party is inclined to alienate the predominant rural votes by continuing settlement operations as a prelude to periodic revision of land revenue. The trend has been to abate its incidence and to release smaller holdings from payments altogether. No one will cavil at the relief given but it should have been offset by a graded scale of levy from larger holdings.

For identical reasons, most of the states are reluctant to impose agricultural income tax in addition to or in substitution of land revenue. Punjab and Gujarat having the highest and the third highest per capita income in the country do not levy agricultural income tax, though both have 'rationalized' their land revenue systems. Even where levied, agricultural income is treated as an entity by itself and not grossed up with incomes from other sources, either for computing agricultural income tax or income tax proper. Secondly, there is no uniformity in the exemption limits prescribed by the different states. While the limit is Rs. 3,500 in Tamil Nadu, it is Rs. 36,000 in

Maharashtra, *i.e.*, over ten times the limit of Tamil Nadu and over seven times the exemption limit of income tax. Further, in most of the states having agricultural income tax, compounding the tax for a pitiful sum based on the extent of holdings is permitted and widely availed of, defeating the very purpose of taxation of income on the basis of capacity. to pay, As a result of these varying rates and the reluctance of some of the governments to impose or adjust this levy, the combined yield of land revenue and agricultural income tax formed in 1970-71, 0.85 per cent of the net output of the agricultural sector. This is out of line with the yield of income tax, which in the same year formed 2.6 per cent of the net output of the non-agricultural sector.

At long last, it has been realized that without an appropriate contribution by the rural sector, the economic growth of the country cannot be sustained. The Raj Committee has been appointed to study this question and make suitable recommendations. Though the ceilings on land holdings, recently brought into force, will inevitably cut into agricultural incomes, there will still be ample scope and the need for tapping the rural sector. It may well be necessary to amend the Constitution to transfer agricultural income tax to the Union List with the proviso that the collections would be distributed to the States on the basis of their origin. Alternatively, a rental agreement, as for levy of income tax devised in the USA and Canada, could be negotiated with the States to suspend their right in return for predetermined compensations.

Central Levies

Taxation is a major instrument of policy; it is also the means to an end. It provides the wherewithal to the State to sustain its administrative apparatus, to give shape to its social and economic policies and to provide for the security of the country against external aggression and internal disturbances. Taxation draws off a portion of the national income for the aforesaid purposes. In its broad concept, it would embrace all levies by the Central and State Governments and also by local authorities. This study is, however, limited to the central levies.

The central levies are divided into two broad categories; direct taxes—incorporating corporation tax, income tax, wealth tax, gift tax and estate duty—and indirect taxes—comprising customs duties and excise duties. Obviously, the same principle or policy could not be applied to these differing levies. It is difficult, again, to lay down a policy which would hold indefinitely. It has to be varied but only when changing conditions make this inevitable; a levy imposed, for example, to meet a special situation should be taken off when the need for it has disappeared. But, unfortunately, this does not happen and the

taxation system has, thus, become haphazard and irrational. It is this aspect that needs special study and treatment.

Corporation Tax

As a general principle, it may be laid down that corporation tax should siphon off half the profits of the corporate sector, the other half being left for payment of dividend to shareholders, bonus to employees and for building up reserves for modernization and future expansion. The present levy of 55 per cent (65 per cent in the case of private and controlled companies) should, therefore, be scaled down. There is an additional consideration for this adjustment. Government has declared its intention to withdraw the development rebate from June 1, 1974. The reduction from 55 to 50 per cent of the rate will not, thus, make an appreciable difference to its yield. But there is one important ingredient in the computation of profit, which requires re-examination and re-assessment. Under the present dispensation, depreciation is allowed on the cost of a capital asset on the reducing balance method. Though there is a case for adopting a straight line method, it is not of any great moment. There is, however, a case for the adoption of cost of replacement as the basis of calculation. Ignoring altogether the important factor of obsolescence, the cost of replacement of a depreciated asset is admittedly very much higher than its original cost. Yet, corporation tax takes no cognizance of it. It is not only reasonable but essential that some cost adjustment should be allowed. Though a suggestion that the capital cost of an asset should be increased by 20 per cent for calculating depreciation does not go far enough. Its adoption would be logical and growth-oriented, *Pari pasu*, the somewhat arbitrary and artificial distinction between closely held and other companies should be abolished, so must the distinction between private and public limited companies. There is justification however, for a higher levy on foreign companies as the dividends repatriated do not come under the purview of Indian income tax for a levy from the recipients.

It is not a part of this exercise to analyse the Wanchoo Report but nonetheless a passing reference should be made to two recommendations relating to the corporate sector. The committee recommends a levy of one per cent on the capital employed (including borrowed capital) by companies, when the need is to give the corporate sector elbow room to expand, it would be retrograde to impose this levy, which is nothing but a thinly disguised form of wealth tax, which was imposed in 1957 and taken off in 1960 because of its inhibiting impact on industrial growth. The committee also recommends a series of fiscal incentives to foster industrial growth in backward regions. It proposes a tax holiday for five years, exemption from custom duty of machinery and compo-

nents imported and a transport subsidy to units located in comparatively inaccessible regions. It is necessary, however, to sound a note of caution. Industrialization does not necessarily bring about prosperity, particularly to regions which are best suited for the development of agriculture, horticulture, sericulture and poultry farming. There should be corresponding fiscal inducements and even subsidies to areas opting for non-industrial development.

Income Tax

The structure of income tax poses two issues; one is what should be the exemption limit and the other is what should be its incidence in the highest reaches of individual incomes. In determining the exemption limit, it would be only reasonable to take note of the price level in the country at the time and the prevailing purchasing power of the rupee. On both these counts, the present level of Rs. 5,000 a year is low for the low and medium income groups. Shri Chavan has admitted that the present purchasing power of a rupee is less than half of what it was a few years back. He has also admitted that price increases have been steep in the last few months. Even an exemption limit of Rs. 7,500 would not offset the two factors mentioned but it would not be an unreasonable starting base.

This brings me to the controversial area of the levy on higher incomes. The present levy is 97.5 per cent. Together with wealth tax payable, the incidence of taxation is over 100 per cent. Wanchoo Committee has recommended that it should be scaled down to 75 per cent. Its approach was that this should prove disincentive to evasion. When the levy makes it profitable to evade tax on Rs. 30 than to earn honestly an additional Rs. 1,000, the committee avers that there is an inbuilt inducement to evasion in the high incidence of income tax. The official experts have discounted this recommendation as tax evasions, they say, are prevalent "at all levels of income". But the question should be viewed not from the angle of evasion but from the angle of the larger interests of national economic growth. We should consider whether a confiscatory levy does not discourage initiative and enterprise, endeavour and achievement and react on industrial growth. Dr. Kaldor had recommended even a lower rate of income tax, as a part of his integrated scheme for the levy of a wealth tax, expenditure tax and income tax. But, unfortunately, government always accepts and acts on the recommendations of commissions and committees on a selective basis. It disregards the consideration that the recommendations they make are integrated recommendations. logically not, susceptable to piecemeal treatment. But there it is. One can only hope that one of these days, we shall have a finance ministry which believes in an economic miracle and adopts the means by which Dr.

Erhart brought this about in the War-torn economy of West Germany. If the real motive in rejecting the case for lowering the maximum levy is that government's financial schemes will suffer and larger balances in private hands will add to the money in circulation and lead to inflation, government could introduce a scheme whereby, if a person saves 25 per cent of his income in recognized deposits and investments, the *whole* of the amount should be exempted from tax. Likewise, government should not give serious consideration to the clubbing of incomes of a husband and wife as recommended by the Wanchoo Committee for purposes of computing income tax. Under present-day conditions, a large number of wives have to seek employment out of necessity for meeting their household expenses. Clubbing of incomes would, therefore, create genuine economic distress and even disturb the harmony in family life.

Customs Duty

Custom duties should have a dual objective in view. In addition to being a fiscal measure, it should have a conscious purpose in assisting industrial growth in the country. In the early twenties, the scale of import duty on steel together with the grant of a subsidy gave the nascent Tata Iron and Steel a firm foundation, enabling it to develop at one time, as the cheapest producer of quality steel in the world. But, though in theory, this principle still holds, its unimaginative use to foster import substitution without a proper study of its feasibility, has led to indifferent maintenance of established industries, reducing their effective capacity and, in extreme cases, resulting in their closure. It is not possible to quantify in this analysis a revision of the structure of levy of customs duty, which is now an amalgam of *ad valorem* and specific duties, except to advocate a pragmatic approach.

Excise Duty

An excise duty was levied for the first time in 1920-21 on two commodities. In the ten years following, there was a marginal increase in the number of commodities subject to duty to four. Since 1948-49 the coverage has been progressively increased to a large number of commodities, raw materials components, semi-processed goods and finished goods alike. Its yield is expected to rise from a mere 4.68 per cent of total tax revenue in 1920-21 to 56 per cent in 1972-73, making a massive contribution of Rs. 2,470 crores to the central fisc. Just as its coverage and yield have increased manifold, so have the complexities of the levy and its administrative problems.

It is necessary, therefore, to examine whether any consistent policy has been pursued in the selection of commodities and in the determination of the rates to be levied on a wide range of commodities. Generally speaking, low-priced articles of high common consumption and luxury

goods are best suited for excise levy. Commodities with relatively small revenue potential are best left alone. In view of their place in economic development, capital goods should be lightly, if at all, taxed. But these principles have not been observed in extending the sweep of the levy. This is established by the fact that increase in revenue attributable to new levies has not been in proportion to the number of additional commodities brought within the ambit of the levy. Secondly, fiscal preferences introduced to give an impetus to village and small-scale industries have not produced the results intended. It has been so, as preferences were not confined to industries which were complementary and not in competition with organized industry and to those which had distinct potential of becoming self-sufficient. The use of differential excise duties has also led to a fragmentation of units for coming within the preferred sector. This has reduced both production and employment defeating the purpose for which the preferences were designed.

While in the beginning, the coverage being small, it was possible to have a standard pattern of levy, it soon became necessary to devise different criteria and different rate structures for different commodities. Most of the excise duties are specific. Some *ad valorem* and some a combination of the two. Besides these basic duties, there are 'special duties' on 29 commodities, the proceeds of which do not form part of the divisible pool. A few 'additional duties' were introduced in 1957 in replacement of sales tax levied by State Governments on some commodities. The effective rates of excise duty vary widely ranging from 4 per cent in the case of caustic soda to over 300 per cent in the case of motor spirit and high speed diesel oil. Generally speaking, excise duties are multiple levies though there is a large range of exemptions to mitigate the multi-point effect. Because of the wide coverage of the levy and its application to widely different commodities, the administrative processes have tended to become quite elaborate.

The manufacturers are 'licensed' and are required to maintain daily accounts of production and despatches. Despatches are physically controlled by the excise authorities and the duty is collected at the time of 'clearance'. Normally, all clearances are made on gate passes countersigned by an excise officer. To relieve the strain on administration caused by this type of itemized control and physical supervision at various stages of production, the Committee on Central Excise Reorganization recommended that an 'audit type' of control should be introduced as an experimental measure. Since 1962, this modified control is applied to 11 industries. This arrangement permits assessment by the manufacturer himself, subject to a weekly check of the accounts of production, deliveries and payments.

Shri Bhoothalingam had recommended that the present system of

levy should be replaced by a 'general excise duty' which should apply to all production. It would be applicable to the entire production of a unit whatever the number or variety of goods it produces from time to time. The duty would have to be *ad valorem*, being the value of production minus the value of material bought, for purposes of production to prevent what is known as the 'cascade effect'. He claimed that on this basis, the yield of the duties would reflect the growth of production more or less automatically and obviate the need for frequent changes in rates and search for more and more specific commodities. The administration of the tax will essentially be by assessment rather than by any type of physical control. He recognized, however, that the continuance of some of the existing excise duties was required both on revenue and policy reasons. Fourteen commodities, namely, tea, coffee, unmanufactured tobacco, sugar, mineral oil and their products, cotton textiles, rayon, cigarettes, matches, iron and steel, motor vehicles, tyres and tubes, cement and paper, were proposed to be kept outside the purview of the general excise levy and the present pattern of levy continued.

In this context, it is necessary to refer to the 'added value tax' evolved in France. Under this scheme a single general tax is levied at a low rate at the raw material stage. Thereafter, as value appreciates, following further refining and processing, the net appreciation in value attracts the tax. Thus, for example, bauxite is taxed when cleared from the quarry. After smelting into pig, the pig is taxed but the tax paid on bauxite is allowed to be set off so that only the appreciation in value is taxed at that stage. The taxable appreciation is reckoned after deducting not only the value of tax on materials physically incorporated in a product or wasted during manufacture, but also other untaxed elements, such as depreciation on machinery, fuel, manufacturing and selling expenses, advertising, etc. In the net result, therefore, the total tax is fractionalized and is paid as it were in instalments at successive stages. Fractionlization evens out the tax burden over several stages and reduces incentive to evasion. It also facilitates the calculation of drawback of duty on exports. The Central Excise Reorganization Committee had recommended that a special study of the French system should be undertaken to consider its feasibility in Indian conditions. But neither has this been done nor the Bhoothalingam scheme been introduced even on an experimental scale. All this underscores the need for a fresh review of the system of levies. An assessment of the commodities which should be taxed and which should be exempted and, above all, of streamlining the duty to make it rational and simple in its levy and collection is necessary.

Administration

Down to 1963, there was a single Board of Revenue at the apex controlling all the three agencies responsible for collecting income tax, customs duties and excise duties. For historical reasons and due to the primacy of income tax at one time, the Board was invariably headed by an income tax man, and this practice continued even after excise duties had overtaken the yield of all the direct taxes taken together. The Central Excise Reorganization Committee considered that there was little affinity between direct and indirect taxes, and in view of the growing importance and complexities of excise levies, they could no longer be left with the Board as an ancillary responsibility. In pursuance of its recommendation, the Central Board of Revenue was bifurcated into two boards—one for direct taxes and the other for indirect taxes.

The Board for Direct Taxes has currently five functional members, each supreme in his assigned sphere of functional responsibility. But this does not accord with the concept of collective responsility of Board nor make for collective wisdom in the shaping of policy. In consequence, the decisions of the Board have varied from time to time on the personal predilictions of the member concerned. The decisions have not been consistent or coherent and have often proved to be confused and confusing. This lacuna has to be removed.

Secondly, the Board should be autonomous and regarded as the adviser to the Finance Minister on all matters relating to direct taxes. Government should not seek to influence the Board indirectly by giving its members *ex officio* secretariat status. Any directives government chooses to issue should be in writing and made available to Parliament. The board should have a directorate of inspection and an internal audit group, both fully accountable to it. This will enable the Board to take remedial measures and remould policy and procedures when needed. The Directorate of Research and Statistics should be developed into a Tax Research Institute—and its responsibilities should extend to cover all Central levies. Appropriately, it should be under the Finance Ministry, preferably the economic affairs wing, feeding it with material needed not only for formulating budget proposals but also giving it an insight into the interplay of taxes on economic and industrial growth.

These observations apply equally to the Board for Indirect Taxes. In addition, there is the need for coordinating customs and excise duties. There should not be an automatic countervailing excise duty to equal a customs duty levied. To give but one example, a customs duty was imposed on imported tractors, primarily to control the black-market price of tractors but also to give an element of protection to the nascent tractor industry. The levy of a countervailing excise duty on

tractors manufactured at higher cost does not give the industry any protection but only reduces both its sale and growth potential.

The structure, functions and effectiveness of the apex organizations cannot be disassociated from the nature of the levies and the rules framed for their regulation and collection. A continuous study and analysis of the taxes and a simplification of procedures should go a long way in removing the crisis of confidence which haunts the tax-payer and the collecting agents alike. In conclusion, I would advocate that a taxation enquiry commission should be constituted, without a political element in its composition, to take a fresh look at all central and state levies and to lay down guidelines for determining what should be regarded as the equitable share of the State in the national income.

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Comptroller and Auditor-General of India and the UK—A Comparison*[1]

S. L. Shakdher

THE COMPTROLLER and Auditor-General of India is appointed by the President by warrant under his hand and seal and he can only be removed from office in like manner and on like grounds as a Judge of the Supreme Court[2]. The President makes the appointment to the office of the Comptroller and Auditor-General on the advice of the Prime Minister. The incumbent of the post is usually one who has held high appointments in the Central Government Secretariat, for a wide knowledge and experience of the administration of the Government Departments are considered indispensable to this office.

The Comptroller and Auditor-General, before he enters upon his office, makes and subscribes before the President or some person appointed in that behalf by the President an oath or affirmation according to the form[3] set out in the Constitution.

The Comptroller and Auditor-General has full administrative control over all the officers and staff serving in the Audit Department except that first appointments to the Indian Audit and Accounts Service are

*From *Indian Journal of Public Administration*, Vol. IV, No. 4, October-December, 1958, pp. 393-410.

[1]The article is based on the writer's first hand knowledge of the working of the Public Accounts Committee in India and on the discussions which he had in London some years ago with late Sir Frank Tribe, Comptroller and Auditor-General of the UK and with the Clerk of the House and the Clerks of the Financial Committees of the House of Commons and the written material supplied.

[2]Clause (4) of Art. 124 of the Constitution says :

"A Judge of the Supreme Court shall not be removed from his office except by an order of the President passed after an address by each House of Parliament supported by a majority of the total membership of that House and by a majority of not less than two-thirds of the members of that House present and voting has been presented to the President in the same session for such removal on the ground of proved misbehaviour or incapacity "

[3]The form of oath/affirmation is as follows :

"I,............, having been appointed Comptroller and Auditor-General of India do swear in the name of God/solemnly affirm that I will bear true faith and allegiance to the Constitution of India as by law established, that I will duly and faithfully and to the best of my ability, knowledge and judgment perform the duties of my office without fear or favour, affection or illwill and that I will uphold the Constitution and the laws."

made by the President and powers regarding major disciplinary action in regard to the officers of that service, *viz.*, dismissal and removal from service vest in the President. The President can prescribe by rules the conditions of service of persons serving in the Audit and Accounts Department and the administrative powers of the Comptroller and Auditor-General only after consultation with the Comptroller and Auditor-General[4].

The Comptroller and Auditor-General submits his Audit Report relating to the accounts of the Union to the President and that relating to the accounts of a State to the Governor of the State. The Constitution requires the President and the Governor to cause it to be laid[5] before each House of Parliament or before the legislature of the State as the case may be.

The salary and other conditions of the service of the Comptroller and Auditor-General are required to be determined by Parliament[6] by law and neither his salary nor his rights in respect of leave of absence, pension or age of retirement can be varied to his disadvantage after his appointment. The Comptroller and Auditor-General (Conditions of Service) Act, 1953, regulates certain conditions of his service in the matter of term of his office and pension. Other conditions of service, save as otherwise expressly provided for in the Act are as specified in the Second Schedule of the Constitution. Under the Act, his term of office is fixed at 6 years. He is debarred[7] from eligibility for further office either under the Government of India or under the Government of any State after he has ceased to hold his office. The administrative expenses of his office are charged[8] upon the Consolidated Fund of India.

No minister represents the Comptroller and Auditor-General in the Houses of Parliament and no minister can be called upon to take any responsibility for any actions done or omitted to be done by him.

All the foregoing provisions go to show that the Comptroller and Auditor-General is an independent authority, free from control by any executive department of the government or the government of the day.

The Comptroller and Auditor-General is required to perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law by Parliament and, until provision in that behalf is so made, to perform such duties and exercise such powers as were conferred or exercised by the Auditor-General of

[4]Art. 148 (5) of the Constitution of India.

[5]Art. 151, *ibid.*

[6]Art. 148 (3), *ibid.*

[7]Art. 148 (4), *ibid.*

[8]Art. 148 (6), *ibid.*

India immediately before the commencement of the Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively[9]. Parliament has not so far prescribed by any law[10] the duties and powers of the Comptroller and Auditor-General. Some Acts[11] of Parliament constituting corporations or other bodies have in individual cases prescribed that the Comptroller General should conduct the audit of such corporations or bodies. In the main, therefore, his duties continue to remain the same as were being performed by the Auditor-

[9]Art. 149 of the Constitution of India.

[10]It has been stated recently that a Bill on the subject is under preparation and will be brought before Parliament in due course. It is likely that the comments of the Public Accounts Committee may be invited on the Bill. In this connection, it may be noted that in the UK the first Exchequer and Audit Department Bill was prepared by the Treasury with the assistance of the Board of Audit and was introduced in the House by the Prime Minister. The Bill was committed by the House to the Public Accounts Committee which was then five years old. The Committee considered the clauses of the Bill, took evidence on it and made certain amendments.

See paragraph 2 of the historical memorandum prepared by the Comptroller and Auditor-General which was attached to the report of 1916 Public Accounts Committee.

[11](*a*) Damodar Vally Corporation Act, 1948.

(*b*) The Employees' State Insurance Act, 1948.

(*c*) Industrial Finance Corporation Act, 1948.

(*d*) Rehabilitation Finance Administration Act, 1948.

(*e*) Air Corporations Act, 1953.

See also Section 619 of the Indian Companies Act, 1956, which provides as follows :

"619. *Application of sections 224 to 233 to Government Companies:* (1) In the case of a Government company, the following provisions shall apply, notwithstanding anything contained in sections 224 to 233.

(2) The auditor of a Government company shall be appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor-General of India.

(3) The Comptroller and Auditor-General of India shall have power :

(*a*) to direct the manner in which the company's accounts shall be audited by the auditor appointed in pursuance of sub-section (2) and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;

(*b*) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information of additional information to be furnished to any person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order, direct.

(4) The auditor aforesaid shall submit a copy of his audit report to the Comptroller and Auditor-General of India who shall have the right to comment upon, or supplement, the audit report in such manner as he may think fit.

(5) Any such comments upon, or supplement to, the audit report shall be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

General of the Dominion of India before the Constitution came into force in accordance with Government of India (Audit & Accounts) Order, 1936, as adapted by the India (Provisional Constitution) Order, 1947.

Before the Constitution came into force, the functions of the Auditor-General of the Dominion of India included keeping of accounts for Civil (except Railways) and P. & T Departments of the Government and also making of payments in certain cases on their behalf—functions which normally belong to administrative departments. The transfer of accounting functions relating to railways from the Auditor-General to the Railway authorities was completed by stages in 1929. The Defence accounts have always been under the control of Financial Adviser—Defence Finance—a wing of the Ministry of Finance of the Central Government. The Initial and Subsidiary Accounts Rules[12] placed the responsibility for keeping the initial accounts on Treasuries and Departmental officers. The responsibility for payment by the offices under the control of the Comptroller and Auditor-General (*i.e.*, Civil Accountants-General and Accountant General, Posts and Telegraphs) related to only a few provincial Headquarter stations.

The above position still continues despite the fact that Parliament and the Public Accounts Committee have repeatedly pointed out the desirability of transferring the remaining accounting and payment functions to the administrative departments. Through the concerted efforts of the Comptroller and Auditor-General and the government to bring about this obvious reform, some headway in a small measure has been made recently. But the scheme of separation of accounts from the audit shows no marked progress or early fulfilment on the ground of deficiency of trained manpower and extra cost involved[13].

[12]The rules were made under sub-para (3) of Para 11 of the Government of India (Audit and Accounts) Order, 1936.

[13]Sometimes other arguments against the separation of accounts from audit are put forward. In the opinion of the present writer they seem to be based on expediency and practical difficulties in the working of the scheme as opposed to the fundamental principle of having a small, compact, efficient and totally independent audit organisation in accordance with the spirit and provisions of the Constitution. Such arguments briefly summarized, are as follows :

(*i*) Accounting and audit functions are inter-related. The precheck of claims before admission for payment, the examination of contract documents, etc., with reference to financial principles and practices undertaken in accounting are essentially audit processes. Therefore, there is nothing inherently wrong in combining the two functions.

(*ii*) An audit independent of administration is necessary to ensure that the internal accounting organisation has not slurred over its responsibility and has not been coerced by the administration in admitting questionable claims and overlooking irregular practices. Where the accounting organisation

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Therefore in spite of the Constitutional provisions placing the Comptroller and Auditor-General in an entirely independent position, a certain subordination on his part to the government insofar as accounting and payment functions are concerned is implied, though under a well regulated convention which government fully and scrupulously observe, government seldom interfere in the discretion of the Comptroller and Auditor-General in his day-to-day administration.

The combination of audit functions with the accounts and payment functions is likely to bring—and it frequently does bring—the Comptroller and Auditor-General under and indirect control of the Minister of Finance, for the minister is very often called upon to answer questions in Parliament on matters which are handled by the Comptroller and Auditor-General on his behalf. The Speaker of the Lok Sabha, the late Shri G.V. Mavalankar, ruled that so long as the Comptroller and Auditor-General was responsible for maintaining accounts in addition to conducting audit, admissibility of questions relating to the former must be regulated as in the case of any other ministry. In regard to audit functions of the Comptroller and Auditor-General, questions relating to day-to-day administration are not normally admitted, but questions involving supply of factual data or statistics or on matters which have a bearing on policy may be admitted. Normally such questions are admitted for written answer only so that the need for raising supplementaries may be avoided. The Minister of Finance, who is responsible for answering such questions in the House, in practice gets in the material for answer from the Comptroller and Auditor-General and places it before the House and may answer supplementaries from such additional material as the Comptroller and Auditor-General may have furnished him. In case the minister has no information, he informs the

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itself is outside the control of the administration, there does not appear to be any objection in the combination of the two functions.

(*iii*) Under the rules at present in force, certain responsibilities in the field of accounts have been imposed on the Comptroller and Auditor-General. Therefore, arrangements will have to be made for the consolidation of departmental accounts and the compilation of finance accounts of the Central and State Governments as a whole. This coordinating role will imply that uniformity in accounting principles and processes in the units dispersed in the various ministries has to be maintained. In this connection, the recent reorganisation of the States on linguistic basis, where official business is transacted in the language of the States, has raised yet another obstacle in the way of uniform accounting procedure.

(*iv*) As the Constitution provides for a single Comptroller and Auditor-General unlike other federal Coustitutions, the implication of the disintegration of a specialised department which has been built up over a period of a century with traditions of integrity and efficiency have to be studied carefully.

House that he will request the Comptroller and Auditor-General to look into the matter.

II

In the UK, the Comptroller and Auditor-General—his full title being "Comptroller-General of the Receipt and Issue of Her Majesty's Exchequer and Auditor General of Public Accounts"—is appointed by the Crown by Letters Patent on the advice of the Prime Minister, but he is not required to make and subscribe an oath or affirmation before he enters upon his office. Like his Indian counterpart, the person appointed to the office has always held senior appointments in the Civil Service. The Comptroller and Auditor-General holds his office during good behaviour, subject however to his removal therefrom by the Crown on an address from the two Houses of Parliament. The Comptroller and Auditor-General is regarded as an officer of Parliament and his functions are set out in the Exchequer and Audit Department Acts of 1866 and 1921.

The duties and functions of the Comptroller and Auditor-General are or can be imposed upon him by: (1) Statutes, and (2) the Treasury. In carrying out the first of these, the Comptroller and Auditor-General is not responsible to the executive. Questions in Parliament about his activities in this respect would be out of order as involving no ministerial responsibility and therefore would not be received at the Table. If it were to be alleged that the Comptroller and Auditor-General is not carrying out these dutie. properly, it will be in order, though in fact it has never been done, for the member making the allegations to put down a motion for an address to the Crown asking for the removal of the Comptroller & Auditor-General. In considering the Comptroller and Auditor-General's functions, it must be borne in mind that the questions arise from the desire for infomation of an individual Member, not of the House. Since the Comptroller and Auditor-General is regarded a servant of the House and not of an individual Member, a question is not the appropriate method for eliciting additional information from him. The proper procedure is to move for a Return ordering him to produce the required information. But, here again, this procedure has never been adopted.

As regards the second category of the Comptroller and Auditor-General's duties, however, he is differently placed since the executive lays those duties upon him and so, to the extent ministerial responsibility exists, questions are in order. Questions asking, for example, whether accounts not previously subject to the audit should in future be made so subject, have frequently been admitted. Questions concerning

the establishment[14] of the Exchequer and the Audit Department, the staff of which are civil servants, can similarly be asked. Such questions would be addressed to the Chancellor of the Exchequer and answered by the Financial Secretary to the Treasury. He would, of course, take the responsibility for answering any supplementary questions although in case of doubt it would be for the Chair to decide whether the supplementaries to the questions are in order.

In the UK, the Comptroller and Auditor-General is concerned with the Audit and Exchequer functions only. Every appropriation account[15] is examined by him on behalf of the House of Commons and in the examination of such accounts the Comptroller and Auditor-General satisfies himself that the money expended has been applied to the purpose or purposes for which the grants made by Parliament were intended to provide and that the expenditure conforms to the authorities governing it[16]. The Comptroller and Auditor-General is required to report to the House of Commons any important change in the extent or character of any examination made by him.

The Comptroller and Auditor-General is also required to examine on behalf of the House of Commons all the statements of accounts showing the income and expenditure account of any ship-building, manufacturing, trading or commercial services conducted by any Department of the Government, together with such balance sheets and statements of profit and loss and particulars of costs as the Treasury may require them to prepare and he shall certify and report on them to the House of Commons.

Both in India and the UK, the Comptroller and Auditor-General may undertake by consent the audit of accounts[17] of *ex officio* transactions of Public Offices in non-voted money, of semi-independent or independent bodies and certain international bodies.

In the UK, the dates when the accounts should be compiled by the Departments concerned and transmitted to the Audit Department and the reports thereon submitted by the Comptroller and Auditor-General to the House of Commons are laid down by the Exchequer and Audit Department Act and all concerned are required to conform to these dates. The time table is so devised that the accounts relating to civil services and revenue departments including all other trading

[14]The total staff of Audit Department is 500 of which 400 are auditors.

[15]There are 160 Appropriation Accounts.

[16]Section 26(7) of the Exchequer and Audit Department Act, 1866.

[17]In the UK, such accounts cover a wide range of activity, some like the Hospital accounts directly financed from Votes and others like the Insurance Fund Account financed mainly from contributions. There are a number of semi-public accounts such as those of the Church Estates Commissioners. In all, he certifies about 370 accounts each year.

accounts relating to ship-building, manufacturing, trading and commercial accounts should be presented to the House of Commons by the 31st January and the accounts relating to army, navy and air force should be presented to the House of Commons by the 15th March, after the termination of the financial year to which the relevant accounts relate.

In the UK, the Comptroller and Auditor-General audits the accounts of the receipts of revenue and of every receiver of money which by law is payable into the Exchequer. In India, however, several important categories[18] of revenue are still not audited.

Both in India and the UK, details of the expenditure out of the secret service are not examined by the Comptroller and Auditor-General and Parliament is content with a certificate to the Appropriation Account saying that the amount shown in the account to have been expended is supported by certificates from responsible ministers or officers, as in India the Secretary of the Ministry concerned gives the prescribed certificate.

In the UK, it is laid down in the letter of appointment of Accounting Officers, who are as a rule permanent Heads of Departments and generally recognized by ministers, that it is their duty to represent to ministers their objections to any course of action which they regard as involving inefficient or uneconomical administration. If such objections involve the Accounting Officer's personal liability on a question of formal regularity or propriety, he has to set out his objections to the proposed expenditure and his ground for it, in writing, to his minister, and he only makes the payment upon a written instruction from his minister overruling the objection. After making the payment he informs the Treasury of the circumstances and sends the papers to the Comptroller and Auditor-General for the information of the Public Accounts Committee, which would no doubt then acquit him of any personal responsibility for the expenditure.

In India since the 20th August, 1958, when revised arrangements

[18]At present, except in regard to customs, no test audit of revenue is being conducted by the Comptroller and Auditor-General. In his latest audit report, the Comptroller and Auditor-General has suggested that it would be desirable to conduct such checking of other revenue heads, especially income-tax.

In this connection, it is useful to bear in mind the following quotation from the review of the working of the Exchequer and Audit Department Act of 1866, prepared by the Comptroller and Auditor-General in the UK in 1916:

> the knowledge that the Comptroller and Auditor-General was cognizant of the manner in which the dispensing power was exercised and might report to the Public Accounts Committee any case in which he considered that the particular exercise of the power ought to be brought to the knowledge of the Committee or of Parliament would of itself act as a check against any undue inclusion owing to leniency on the part of the different revenue departments.

for financial control were introduced whereby wide financial powers were given to administrative ministries and financial advice was decentralised, it has been laid down as follows:

> All cases in which the advice tendered by the Financial Adviser of the Ministry is not accepted should be referred to the Secretary of the Ministry for his orders and if the Secretary also differs from the advice, the case should be brought to the notice of the Minister. A monthly statement of cases, if any, where the Financial Adviser's views have not been accepted, giving a summary of the differences and the final decision should be forwarded by the Secretary of the Ministry to the Ministry of Finance for information, a copy being endorsed to the Comptroller and Auditor-General simultaneously.

III

Both in the UK and in India audit reports of the Comptroller and Auditor General stand automatically referred to the Committee of Public Accounts which in the UK consists of Members of the House of Commons only while in India it is a body composed of fifteen Members of the Lok Sabha, with which seven Members of the Rajya Sabha are associated at the request of the Lok Sabha, the request being renewed every year by a separate resolution of the Lok Sabha in which the Rajya Sabha is asked to concur before nominating its Members.

The functions of the Public Accounts Committee in the UK and India are respectively laid down in the Standing Orders of the House of Commons and in the Rules of Procedure of the Lok Sabha.

It is often stated that the function of the Public Accounts Committee —*i.e.,* the scrutiny of audit reports—is merely *post mortem.* Speaker Mavalankar, while speaking at the inaugural meeting of the first Public Accounts Committee which was set up after the Constitution came into force, deprecated this approach and asserted that the "Public Accounts Committee can influence a good deal even the running administration as we always profit by past experience." As some one has said, the great progress which medical science claims today and has undoubtedly attained is mainly based on the detailed *post mortem* researches conducted all these years. Referring to the approach which the Public Accounts Committee should adopt in doing its work, Speaker Mavalankar made the following significant observations:

> (*i*) I have always believed that after all, whatever the quality and quantum of expert knowledge, it has to be tested by the service it renders to the common consumer and therefore the consumer's or the layman's ideals in this respect have to be taken into consideration.

(*ii*) Members of Parliament will better understand the intention and the mind of Parliament than the Comptroller and Auditor General and they can better exercise their discretion and judgement.

(*iii*) We are divided, opposed, so long as we discuss a matter and so long as finality is not reached. The moment finality is reached it should be the effort of every one to support that. You are sitting in the Committee to go by what Parliament has laid down. The direct corollary is that there must not be any party politics so far as examination of the accounts is concerned.

(*iv*) Even in cases where the Committee finds that money has not been properly spent or proper sanction has not been obtained or that the interpretation put by the executive officers or the Audit Department is wrong, we have to see their point of view and unless one is convinced by proof, not by mere suspicion, that there is something wrong somewhere in the sense that there is some misappropriation or mishandling of the money, our approach has always to be one of sympathy and one of give and take.

These principles cast a heavy responsibility on the Comptroller and Auditor General to so conduct the audit of accounts that a really objective analysis of his findings is available to the Committee and the facts on which his observations are based are undisputed. This also means that only first class issues are brought before Parliament and the Public Accounts Committee through his reports and minor and technical details are eschewed.

Both in the UK and India, the reports[19] of the Comptroller and Auditor-General are the basis of the investigation of the Public Accounts Committee and, although they are necessarily brief, a whole

[19]In paragraph 1 (introductory) of Audit Report (Central Civil) 1955 the Comptroller and Auditor-General has stated as follows:

> Irregularities in respect of which adequate remedial measures including suitable disciplinary action where necessary have been taken by government, have been excluded from this report.
>
> A similar para was included in the Audit Report Defence Services 1957.
>
> There is no such stipulation in the UK Audit Reports.

Thus the Comptroller and Auditor-General in India, has taken it upon himself to judge *finally* in every case of irregularily whether *adequate*: (*a*) disciplinary action has been taken, and (*b*) steps have been taken to prevent such cases in future. Parliament and the Public Accounts Committee do not see the light of such cases, There is a danger that parliamentary control over public expenditure may be vitiated if facts relating to the irregularity committed and the action taken by government are not included in the audit reports and the matter is left to be determined between government and the Comptrollor and Auditor-General departmentally.

year's work of the entire Department is available to the Committee. So far as the technical examination of the expenditure incurred by the Government Department is concerned, the Audit Department has delved deeply and brought to bear upon such examination all its expert knowledge and experience. It is then for the Committee of Public Accounts to apply its mind from the layman's point of view, as pointed out by Speaker Mavalankar, and to make its observations from the taxpayer's and consumer's point of view.

The Audit Reports, together with the connected Appropriation Accounts, are so voluminous that it is impossible for a layman to have an idea of all the facts and figures contained in the documents in a reasonably short time. In order to assist the Members of the Public Acconnts Committee, a key of the Audit Report and the connected Appropriation Accounts and other papers (which used to be prepared by the Comptroller and Auditor-General until recently) is now prepared by the Secretariat of the Committee and copies thereof circulated to the Members in advance.

In paragraph 24 of the historical memorandum attached to the 1916 UK Committeee's Second Report, it is stated that:

> The Public Accounts Committee have never considered that the Comptroller and Auditor-General is limited in his Reports merely to those points which he is bound to bring to the notice of Parliament. The Committee of 1888 stated that while it is no doubt difficult in all cases to draw a distinction between questions bearing directly on audit matters and those which may trench on administrative functions, yet at the same time, if in the course of his audit the Comptroller and Auditor-General becomes aware of facts which appear to him to indicate an improper expenditure or waste of public money, it is his duty to call the attention of Parliament to them. The Select Committee of 1902 on National Expenditure recommended the Public Accounts Committee, even more than in the past, to encourage the Comptroller and Auditor-General to scrutinise and criticise improper or wasteful expenditure.

The Comptroller and Auditor-General in India has construed his powers in a similar manner and he has in fact sometimes raised larger questions involving wiser spending and reforms in procedure, organization, change of rules, etc.[20]

[20]Examples of such matters are:

1, The Comptroller and Auditor-General suggested that for better organization and to secure efficiency it was worthwhile to introduce the administrative audit system by the departments concerned even if it entailed a little extra

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In the UK, accounts other than Appropriation Accounts audited by the Comptroller and Auditor-General are presented to Parliament as White Papers while in India they are laid on the Table of the House like any other documents.

In the UK, the Comptroller and Auditor-General is not responsible for auditing of accounts of public corporations and therefore he has no access to the relevant books and makes no report on their accounts[21]. His advice to the Committee on these accounts is therefore necessarily restricted and often the Committee have to depend upon themselves for the examination of such accounts. In India too, the Comptroller and Auditor-General is precluded from auditing the accounts of some of the corporations or statutory bodies and the Committee of Public Accounts have to proceed on the basis of the audit reports submitted by the commercial auditors whom the statutory corporation may have appointed as their auditors.

In the UK, each year a number of accounts are considered without witnesses being summoned to answer for them. It is the ideal that the programme should be arranged so that, over a period of years, the Committee should have the opportunity to examine the accounting officer for every account, but the accounts are now so numerous that a greater degree of selection is exercised. Unless the Comptroller and

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expenditure. [Para 21 (*i*) (3) of Audit Report (Civil), 1950].

2. Government is not competent to regulate air travel for Ministers under executive orders. [Para 22(*c*) of Audit Report (Civil), 1950.]
3. It was improper to grant to Judges any emolument not provided by law. [Para 24(*p*) of Audit Report (Civil), 1950.]
4. Procedure with regard to placing of contracts should be changed. [Para 24 of Audit Report (Defence), 1950.]
5. The Comptroller and Auditor-General should havet he right to audit expenditure of the State-sponsored concerns, by whatever name they were called. (Comptroller and Auditor-General's statement at Appendix 1, 3rd Report, First Lok Sabha).
6. Suggestions made regarding scrutiny of Budget Estimates and revision of financial control in the verious Ministries. [Appendix to Audit Report (Civil), 1955, Pt. I.]

[21]In the UK, Nationalised Industries, till the enactment of the Finance Act, 1956 (Section 42), were required primarily to raise the necessary capital in the market usually by issue of debentures and were responsible for servicing them. The Treasury had only to guarantee the payment of interest and the redemption of debentures. Under the Finance Act, 1956, the borrowing powers of the Nationalised Industries (other than National Coal Board) have been curtailed and they are expected to take advances from the ministers concerned to the extent they had powers to borrow by the issue of Stock and the Treasury in turn is expected to issue to those ministers out of Consolidated Fund such sums as are necessary to enable them to make requisite advances. In India, on the other hand, Public Undertakings are financed largely, if not entirely by the direct investment of public funds from Consolidated Fund of India.

Auditor-General makes some comments on the accounts in his reports, not even the accounts of some of the major departments are examined every year with a witness present.

A provisional programme usually prepared by the Comptroller and Auditor-General in the light of his knowledge as to what is likely to be contained in the report on his accounts is submitted by him to the Chairman of the Committee. The Chairman finalises the programme after taking into account his own ideas and also the current interest of the Members. Accounts which were taken without a witness in the previous session and which it is now proposed to take with one or *vice versa* are underlined. Any new accounts which have not been taken before are typed in capitals.

In India, the programme is prepared by the Secretariat of the Committee after the Audit Reports and Accounts have been presented to the House. The provisional programme after approval by the Chairman, is circulated to the Members and the concerned ministries. All accounts with the exception of those few which relate to minor departments are usually examined by the Committee each year. Thus all Heads of Departments have to appear before the Committee every year.

In the UK, before the commencement of each meeting of the Public Accounts Committee, a conference is held in the room of the Chairman of the Committee. At this conference, the Chairman, the Comptroller and Auditor-General and the Clerk of the Committee are present. The conference discusses the important points which should be raised with the witnesses regarding examination of particular accounts. This is always a confidential meeting and no records are kept nor circulated to any one. This meeting gives the background to the Chairman in the light of which the witnesses are examined. Other Members have no such knowledge and therefore most of the examination of the witnesses is done by the Chairman and most Members appear "rather in the role of a juror who will come later to some conclusion on the matters at issue".

In India, the Comptroller and Auditor-General prepares a list of important points arising out of the accounts and his comments thereon and this list which is marked 'confidential', is circulated to the Chairman and the other Members of the Committee. The Secretariat of the Committee, under the direction of the Chairman, prepares a further list and it is also circulated to the Members of the Committee. The latter list supplements the list prepared by the Comptroller and Auditor-General. Thus the examination of the witnesses is conducted by the Chairman and Members alike and Members feel the satisfaction of having participated to the full in the discussions[22].

[22]Quite recently the Public Accounts Committee has adopted a procedure of

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In the UK, the Comptroller and Auditor-General attends the meetings as a witness when evidence is being taken by the Committee. He does not sit next to the Chairman; but sits at the other end of the table opposite to the Treasury officials and intervenes in the discussion only when the Chairman asks him to clarify a point or some information is required from him. He does not put any question to the witnesses nor makes any comments or observations on the evidence given by a witness.

In India, on the other hand, the Comptroller and Auditor-General sits on the right hand side of the Chairman. He continuously holds consultation with the Chairman as the evidence is proceeding and very frequently asks questions from the departmental witnesses and also makes comments and observations in the course of such evidence. The Comptroller and Auditor-General is accompanied by his officers[23] who also sit alongwith him or behind him and continuously assist him with papers, information, etc.

In the UK, no formal procedure has been laid down governing the participation of the Comptroller and Auditor-General in the drafting of the Committee's report. The Committee are however free to call upon the Comptroller and Auditor-General and to make use of his help in any way they think proper.

In India, when a draft report is prepared by the Secretariat of the Committee under the direction of the Chairman, it is sent to the Comptroller and Auditor-General in advance for factual verification and when the report is considered by the Committee, the Comptroller and Auditor-General is always present to assist the Committee. His

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dividing itself into working groups. Each such group is entrusted a particular subject. The members of the group study the papers on the subject and hold preliminary meetings among themselves to discuss points of importance on which questions might be put to the witnesses. At such meetings the Comptroller and Auditor-General or his officers are also present to assist the members.

[23]Para 19 of the Audit and Accounts Order 1936 as adapted reads as follows:

19. Anything which under this Order is directed to be done by the Comptroller and Auditor-General may be done by an officer of his Department authorised by him, either generally or specially;

Provided that except during the absence of the Comptroller and Auditor-General on leave or otherwise, an officer shall not be authorised to submit on his behalf any report which the Comptroller and Auditor-General is required by the Constitution to submit to the President or the Governor.

Accordingly the Comptroller and Auditor-General has appointed several Accountants-General and Directors of Audit as his principal audit officers who act on his behalf and this explains the reason for their presence at the meetings of the Public Accounts Committee. In fact, the audit reports are signed by the Accountant-General or Director of Audit concerned and countersigned by the Comptroller and Auditor-General.

presence is recorded in the proceedings of the Committee. The Comptroller and Auditor-General is, as usual, accompanied by his officers on such occasions also.

In India, the minutes of the Public Accounts Committee are drafted by the Secretariat of the Committee and after approval by the Chairman are circulated to Members. The minutes form part of the Report of the Committee and supplement the recommendations contained in the main Report. The documents supplied to the Committee are also appended to the Report of the Committee; but the evidence given orally is not printed[24] nor laid on the Table of the House. The minutes are therefore of a detailed character and embody a good summary of the discussions without mentioning actual questions and answers or the names of members or the witnesses. In the UK, on the other hand, the minutes are very brief and do not purport to summarise the evidence given before the Committee. The evidence is printed verbatim and presented to the House alongwith the Report. Neither in India, nor in the UK, the Comptroller and Auditor-General is concerned with the drafting of the minutes of the Committee.

In the UK, it is customary on the retirement of the Comptroller and Auditor-General and on the appointment of his successor to include a special paragraph in the Committee's final report. In India, the Committee includes a paragraph in each of its reports every year expressing its thanks to the Comptroller and Auditor-General for the valuable assistance rendered by him in the deliberations of the Committee.

In the UK, periodically an epitome of the reports of the Public Accounts Committee is brought up-to-date by the Comptroller and Auditor-General. It is customary for the Chairman of the Public Accounts Committee to move in the House for a return containing the epitome of the reports from the Committee and of the Treasury minutes thereon with appendix and index. Before doing so, the Chairman writes to the Financial Secretary to the Treasury asking him to inform the Speaker that he has no objection to the motion. In India, a similar epitome is brought out by the Comptroller and Auditor General. This epitome is kept in the Library of the Public Accounts Committee and is not laid on the Table of the House.

[24]Before World War II the evidence used to be printed. It was stopped during the war as an economy measure. Since then except on one occasion (1952-53) the evidence has not been printed nor laid on the Table. The Committee has examined this matter from time to time; but have not yet made up their mind to make it public. Apart from printing difficulties, which have now eased, the main consideration for keeping the evidence confidential is the creation of a psychological atmosphere in the mind of a witness to say freely and frankly what he feels about a certain matter placed before him.

In India, six copies of all papers circulated to the Members of the Committee are usually forwarded to the Comptroller and Auditor-General and the Accountant-General or Director of Audit concerned. Any fresh note or memorandum which the Committee desire is invariably sent by the witness through the Office of the Comptroller and Auditor-General, who check, the facts contained in the memorandum from the audit point of view before it is submitted to the Committee. The idea is that the facts should be settled between the administrative department and the Audit Department before they are placed before the Committee. Copies of the final memoranda which are circulated to the Members of the Committee are also sent to the Comptroller and Auditor-General. The Chairman and the Committee have often commented[25] on this and also criticised the delays in submitting written material. Often the Committee has had to delay its report for this reason.

IV

In the UK, Supply is granted by the terms of the resolution of the House to 'Her Majesty'. Ways and Means are granted by the Appropriation Act in the form of an authority to the Treasury to make the necessary issue from the Consolidated Fund. Before the grants become available to the various departments, a Royal Order "is issued by which the Sovereign authorises the Treasury to issue the necessary money to the persons charged with the payment of services", the order being limited to the amount of Supply actually granted by Parliament at the time of its issue. The Royal Order quotes the amount granted in each Supply resolution and the date on which it was agreed to by the House of Commons on report. But before it can draw the money from the Consolidated Fund to make the issues to the various departments, the Treasury must receive from the Comptroller and Auditor-General credits on the Exchequer Accounts at the Bank of England.

[25]See introduction to 3rd and 4th Reports of the Public Accounts Committee (Second Lok Sabha).

It may be stated in this connection that in order to understand this difference in procedure the position in the UK is that as far as possible complete information is given to the Public Accounts Committee by the departmental witnesses in oral evidence and there is seldom any occasion for them to submit any notes in writing. The departmental representatives generally attend the meetings of the Public Accounts Committee by themselves (and with one or two Assistants if necessary) and carry important and relevant papers only. In India, on the other hand, the departmental representatives, despite the fact that they attend the meetings with a larger retinue of staff, who carry voluminous records with them, do often ask for time to explain their position in writing by submitting notes later on.

The Treasury therefore send to the Comptroller and Auditor-General a demand every afternoon for the issue of such sums as are needed to finance the many activities of the government. The Comptroller and Auditor-General examines these demands and if he is satisfied that they are in accordance with parliamentary authority issues credit notes authorising the Banks of England and Ireland to issue the money. The procedure today is exactly the same as that laid down by Parliament over 90 years ago[26].

In India, by the provisions of an Appropriation Act, the money is granted to the President. After the relevant Appropriation Act comes into force, the Ministry of Finance communicate to the administrative departments (and the Accountants-General concerned) in the shape of a lump sum as primary units of appropriation the sum granted under the Appropriation Act to that Department to defray its expenses on Services and Supplies during the course of the year. The administrative departments then make arrangements for distributing the sanctioned funds where necessary, among the controlling and disbursing authorities subordinate to them. The Accountant-General is required to render such assistance in the distribution of grants as may be settled in each case[27]. No procedure[28] has yet been devised whereby, as in the UK, the Comptroller and Auditor-General in India has been vested with control over the issues from the Consolidated Fund. The responsibility for drawing the money from the Reserve Bank which maintains the Consolidated Fund on behalf of the Government of India and for watching the progress of the expenditure is laid down on the authority administering a grant and for keeping the expenditure within the grant. When the Appropriation accounts are drawn up at the end of the year, then only the Comptroller and Auditor-General is in a position to know whether any authority has exceeded the grant, or whether the government as a whole have drawn in excess of the sum specified in the Appropriation Act from the Consolidated Fund of India. □

[26]Sections 14 and 15 of the Exchequer and Audit Departments Act, 1866.

[27]General Financial Rules. Vol. I, Chapter V.

[28]On the coming into force of the Constitution in 1950, the designation of the Auditor-General was changed to Comptroller and Auditor-General as it was intended that, as in the UK, he should also be responsible for control over exchequer issues.

Two Aspects of Budgeting*[1]

Robert S. Herman

ONE OF the most important needs of every society is an effective government. To be effective, a government requires a sound administrative system which will implement the policies set forth by the political leadership. The administrative process is also a means for systematically evaluating and communicating the needs of the people upward to the political leadership of the government. This process of communication is constantly expediting the movement of policy directives and needs upward and downward throughout the governmental hierarchy.

I

THE BUDGET FUNCTION IN MODERN GOVERNMENT

A sound administrative system is important to the economic, political, and social development of a nation. Economic growth; population changes; the growing complexity and independence of human wants; and the increasing needs for education, health, transportation and other services generally require an expansion in governmental activities. Most of these activities are programmed, coordinated, and financed through the budget process.

Sound financial planning and the effective integration of governmental programmes through the budget are important means of increasing the confidence of the people in their government, improving the welfare of the people, and attaining the national goals.

The improvement of budget administration is an important means of attaining a higher level of administrative effectiveness as well as a means of achieving economic progress.

Budgeting for a large governmental jurisdiction is enormously complex even though certain of its forms and procedures may be highly routinized. The public budget serves a number of purposes and has

*From *Indian Journal of Public Administration*, Vol. VIII, No. 3, July-September, 1962, pp. 317-31.

[1]Based on lectures delivered at the Indian Institute of Public Administration and at the Economic Development Institute of the World Bank.

several major aspects which are separately identifiable yet closely related.

The Role of the Budget

Because all governmental activities require financing, the budget should bring together the plans and the needs of the various agencies and should be a centre for the review and evaluation of departmental activities in the framework of general policies established by the chief executive.

The budget should be a unifying force for organizing the programmes and finances of the government through a systematic decision-making process. The budget process requires strong leadership, sound organization, and effective administrative disciplines.

The budget is a powerful economic force which affects and is affected by the economy to which it pertains. Every budget should be considered in relation to the levels of economic activity, changes in the allocation of resources, the distribution of income and employment, and broad economic objectives.

As an instrument of fiscal policy, the budget should be carefully considered in terms of its effect on the balance of payments, the trade balance, monetary and credit policies, the tax system, price levels, interest rates and other aspects of the economy.

Another important aspect of a public budget is its effect on: (1) the budgets of other governmental jurisdictions (central, provincial, municipal) of the same nation, (2) the budgets of other nations with interacting economics, and also (3) the economic and financial transactions of the private sector of the nation's economy.

Budgeting and Planning

The annual budget (or short-range plan) and the longer range development plan are complementary in character and neither should be considered in isolation, from the other. The annual budget implements the longer-range plan; and the development plan, in turn, is subject to alteration according to the provisions of each succeeding annual budget. In nations where: (1) the preparation and execution of the budget, and (2) the formulation and supervision of the development plan are the responsibilities of different agencies, it is necessary to achieve the highest level of coordination between these agencies in order to establish and achieve common goals.

The relationship between planning and budgeting is probably the most crucial in modern government. These two functions (or parts of the same function) must be integrated both administratively and financially if a nation is to progress toward its objectives in a systematic manner.

Long-range planning without regard for the realities of annual budget implementation becomes an academic exercise of little operational value; budget-making which disregards the co-ordinated needs of the development plan tends to fragmentize the energies of the nation and to retard progress toward national objectives.

It is necessary to achieve an ultimate fusion of planning and budgeting if a government is to move toward its goals, but it is also important to preserve the separate vocational identities of planners and budgeters within this process. The completion of an operational plan, whether short-term or long-term, is usually achieved by a combination of realistic planning and creative budgeting. Before this stage is reached, however, full airing should be given to the views of the visionary planners who are concerned with optimal needs and also the views of the more traditional budget analysts who may be overly-concerned with cautions and restraints. The imagination and boldness of the planners should not be sacrificed too quickly at the altar of budgetary negativism, nor should the idols of the budgetary conservatives be smashed without due regard for their merit.

Close and continuous working relationships should be maintained between personnel engaged in planning and those in budgeting. Uniform terminology, concepts, and classifications, should be agreed upon. Personnel should have access to the same information. Budget justifications and the basis for budgetary decisions (regarding both revenues and expenditures) should be communicated to the planners; and the planners, in turn, should make their studles and formulations and revisions avaliable to the budget-makers. Policies concerning investment allocations must be studied for their effect on future consumption budgets; and current operational decisions must be scrutinized for their impact on future investment budgets.

The ultimate integration of planning and budgeting is the responsibility of the highest level of the government. In governments where planning and budgeting are responsibilities of different ministries, these activities should be coordinated by either the Prime Minister or President, a senior minister, or a junta or commission. Regardless of the administrative structure, the co-ordinating agency must be able to deal authoritatively with matters concerning both planning and budgeting because of the complementary nature of these functions.

The development plan and the annual budget should be formulated in both financial and physical terms wherever possible. Programme and performance budgeting techniques are useful tools for preparing and presenting the budget in terms of *work to be accomplished* in physical, measurable units. This type of budget is also useful in measuring and reporting progress toward the objectives of the development plan especially if these objectives are expressed in terms comparable with

budgetary data.

Organisation for Budgeting

Budgeting for a large organization necessarily requires a complex of interrelationships. The relationship between the legislative body and the executive is basic in determining the nature of the budgetary system. Unduly restrictive legislation often limits the discretion of top executive officials and curtails their flexibility and authority. So long as detailed information concerning budgetary requests and programme accomplishments (together with proper accounting and auditing reports) are constantly available for legislative scrutiny, the chief executive should have sufficient independence to prepare the government's budget for presentation to the legislature, and to execute its provisions after legislative authorization.

Budgeting, as an executive function, should be the direct responsibility of the chief executive. Since the chief executive cannot be a budget-maker, he must concentrate certain responsibilities in a central agency and other responsibilities must be delegated throughout the entire administrative structure. Power should be distributed to make the budget process orderly and to provide for effective leadership in the formulation and execution of policies.

The careful development of work programmes and costs at the lower operational levels of government agencies is one of the fundamental requirements of sound budgeting. The work programmes and activities of these units form the base upon which the total budget is ultimately built.

The budget requests of the operating units should be reviewed and consolidated with those of other units as they proceed up the administrative hierarchy. At each level these requests should be reviewed according to the breadh of perspective of the reviewing agency. This process of screening budgets and assigning priorities should be repeated at each operational level until the departmental budgets reach the minister who is responsible for the final integration of his budget for submission to a central budget agency.

Every budget is much more than the sum of work programmes developed at the operational level, even after allowing for changes made during the review process. Many new programmes and programme changes originate at the top political level and do not depend upon acceptance by the administrative hierachy. Even these, however, must be coordinated with the ordinary budget requests and integrated into a single consistent budget plan. This coordination is one of the functions of the central budget agency, whether this agency is the Ministry of Finance or a separate agency in the office of the chief executive.

The Central Budget Agency

The budget process provides a systematic means of communicating needs upward and policies downward throughout the government. Needs and policies are reconciled at every level, but it is important to have a strategically located central budget agency to coordinate the entire process for the chief executive and his policy-makers. The central budget office should organize and review requests made by the various ministries and should evaluate these requests in terms of the economic, social, political, financial, and administrative policies that are established at the highest executive level.

One of the most important functions of the central budget agency is to help establish priorities among competing departmental needs in terms of the general directives set by the political leadership. This requires the use of various managerial and statistical techniques and also careful judgement and concern for the ultimate objectives of the government.

In order to perform its functions and achieve a unified budget system the central budget agency must have good communication with the chief executive and also with the various ministries and other agencies. This is essential regardless of the position of the budget agency in the administrative structure (*i.e.*, whether it is in the office of the chief executive, a unit in the Ministry of Finance, or part of a special budget commission).

A unified governmental organization structure with broad discretion given to the chief executive is easiest to administer and to budget. The placing of agencies outside the control of the executive makes the budget structure more complicated and harder to coordinate. This has been especially true where important public programmes have been carried on by government corporations or public authorities beyond the direction of the chief executive and a part from the government's budget process.

Staffing the Budget Office

Well-trained personnel are essential to good budgeting. Members of a budget staff should have a diversity background and abilities. An understanding of economics and public administration should be part of the intellectual equipment of all budget officers regardless of their particular speciality. If these disciplines are not part of the basic education of the budget staff, they should be taught through in-service training programmes.

A familiarity with the organization and specific programmes of the government is important, and can be developed through on-the-job experience. Equally important for the budget staff is an understanding of the dynamics of a large organization which is the environment in

which this staff must operate. Continuity of experience and knowledge of the governmental processes are essential, but should be combined with an active approach to operations, management, programming, and planning.

Budget personnel should be 'nodders' in the sense that they accept assignments easily and implement policy directives. They should also be 'prodders' in that they constantly seek and suggest improvements and changes. This 'change-making' quality is often overlooked in the selection of budget analysts who mistakenly presume that they should be negatively inclined. A good budget analyst needs experience, knowledge, imagination, judgement, flexibility, and courage.

A limited number of specialists can be valuable in a budget agency. Persons with training in engineering are helpful in analyzing requests for construction projects; the availability of a medical doctor may be valuable in assessing the merits of health programmes: agricultural specialists and transportation economists are also highly useful in advising on budgetary decisions relating to their particular fields.

Funds or Accounting Structure

Budgetary flexibility is too often limited through a highly compartmentalized fund structure. Special funds for special purposes outside the official budget make it difficult to follow a consistent budgetary policy. Such extra-budget funds also prevent the budget from representing the true magnitude of the government's finances and make economic analysis of the budget especially difficult.

Fragmentation of the budget into a number of separate funds or accounts makes strong executive control and co-ordination impossible. In spite of the political problems involved, it is generally advisable to abolish obsolete agencies and funds, to integrate others with the central government or with provincial or municipal governments and wherever possible to finance necessary autonomous entities by appropriations from the budget rather than by special earmarked taxes.

Legislatures often impose restrictions on the executive by requring specific types of expenditure authorization. Highly particularized, detailed appropriations give less freedom to administrators than do broader forms of authorizing expenditures. Earmarked expenditures (like earmarked revenues) through detailed statutory requirements also limit the discretion of the executive.

Control of Expenditures

Budgeting is essentially a facilitating and coordinating function which requires certain disciplines for its effectiveness. This is particularly true of the expenditure control aspect of the budget. It is extremely important that the responsibility for financial control be clearly defined

and linked closely to managerial responsibility. It is this managerial aspect of financial control (rather than the auditing aspect) which is most pertinent to this paper.

The control of expenditures is an important aspect of financial management and is the responsibility of the chief executive. The details of controlling expenditures must be delegated even though the general responsibility for the expenditure programme cannot be abdicated by the chief executive. Centralized responsibility for expenditure control in a budget agency is important for achieving: (1) operational efficiency and economy; (2) integration and coordination of programmes; (3) improved financial planning; (4) systematic, synchronized budget execution; and (5) responsiveness to policy directives.

The basic *administrative requirements* for effective expenditure control are :

(*a*) *Effective organization* in order that each agency in the budget process understands its responsibility for expenditure control.

(*b*) *Professional staffing* of budget offices with well-trained expert personnel.

(*c*) *Sufficient information* organized properly and promptly for decision making.

(*d*) The *ability to anticipate* the type of information which is pertinent and which may be influential in the development of policies.

(*e*) A *good communication* system so that information moves rapidly through the government and decisions may be formulated quickly and with adequate justification.

(*f*) A proper *distribution of authority* so that each agency can carry out its responsibilities, and leadership can be effective.

(*g*) An *authoritative time-table* to provide that: (1) information will be available when needed, and (2) responsibilities will be executed according to a schedule established to meet the requirements of the chief executive and the legislature.

(*h*) Sufficient *flexibility* to permit adaptation to changing conditions.

Some important *tools* for control of expenditures are :

(*a*) An *accounting system* which is useful for administrative decision-making in addition to its value for auditing purposes. The accounting system should produce data needed to make managerial decisions.

(*b*) Uniform *nomenclature* and *definition of terms* in order to facilitate understanding and communication.

(c) *Budget classifications* to help plan and evaluate policies and objectives. Some useful classifications are: (1) function, (2) programme, (3) organization unit, (4) character, (5) object, (6) time periods, and (7) geographical areas.

(d) A *personnel classification system* which has consistent application throughout the government. Personnel service budgeting is facilitated by graded position classifications arranged according to equitable salary scales.

(e) Well-defined, *standardized procedures* for the analysis and review of budgets.

(f) Sufficient *statistical data* to allow for measurement and reporting of activities and accomplishments.

(g) Performance standards, *work units* and *unit costs* to provide a basis for budgetary decisions. These are also valuable for purposes of reporting and for better understanding of governmental activities.

(h) A maximum degree of *flexibility for the exercise of discretion.* Earmarked revenues and earmarked expenditures tend to rigidify budget making and weaken the expenditure control apparatus. The machinery for transferring funds during the period of budget execution is an important element in expenditure control in order for the budget to adapt to changing conditions.

(i) Accounting controls such as *appropriation codes, allotments, apportionments, line item appropriations, pre-audits,* and *post-audits.*

Programme and Performance Budgeting

One of the most useful recent developments in governmental budgeting is the *programme* or *performance budget.* This type of budget is useful in directing the attention of a government toward its goals and accomplishments, and in focusing emphasis on *progress* rather than effort.

Performance budgeting differs considerably from 'traditional' budgeting. It is a new approach to the governmental budget process rather than being merely another technique for presenting a budget. Performance budgeting requires the development and use of expenditure classifications which are based upon meaningful programmes, activities, and projects rather than on organizational units or particular items purchased. Performance budgeting changes the function and perspective of the central budget agency and has profound effect upon the allocation of responsibility for budgeting throughout the government.

There are at least five broad purposes of performance budgeting: (1) to improve budget review and decision-making, (2) to achieve more

effective internal administration, (3) to measure progress toward long-term objective, (4) to bring operational budgeting and development planning closer together by providing a common language which is useful to both, and (5) to simplify reporting and make government operations better understood by the public and by the legislature.

II

SOME USES AND LIMITATIONS OF PERFORMANCE BUDGETING

The performance budget concept is valid and applicable to all public budgets, and is being used successfully in budgets of business firms in the private sector of the economy. The chief objective of performance budgeting is to achieve a more systematic and rational basis for making decisions relating to the allocation of resources among many competing needs through the budgetary process. By developing data which describe the work to be accomplished in terms of performance standards and unit costs, performance budget techniques provide information which indicates what can be accomplished by spending specific amounts of money under certain circumstances. This knowledge forms a basis for making value judgments and policy decisions among competing programmes by furnishing administrators and legislators with a measurement of value added or progress achieved by particular governmental activities and expenditures. If successful, performance budgeting serves to improve executive and legislative analysis and review of governmental programmes and to produce more effective internal administration. Because of these general values, performance budgeting is applicable to all levels of government—to state and municipal budgets as well as to budgets of central government.

Although the concept of performance budgeting does not change, its specific application varies according to the particular characteristics of the government to which it is being applied. Since performance budget techniques are more useful and more relevant to some activities than to others, it follows that these techniques are not capable of uniform application to every governmental activity.

In general, performance budgeting is most valuable when applied to activities which have end products or work units which are measurable, significant and fairly homogeneous, in order that meaningful, consistent and reliable unit costs may be developed as a basis for analysis and decision-making. Obviously, therefore, performance budgeting has greater application to activities which produce results in terms of measurable entities (such as number of acres cultivated, tax returns audited, miles of road built, tons of garbage collected, pieces of mail delivered, etc.) than, for example, to the activities of a Ministry of

Foreign Affairs which do not lend themselves to precise measurement of end products in terms of work units or unit costs that are meaningful in judging the effectiveness of the ministry.

Applicability to Grants-in-Aid

Performance budgeting has somewhat different application in federal governments and in unitary governments. In federal governments such as India, the United States and Canada, a substantial portion of the national expenditure consists of grants-in-aid to states or provinces which spend the money directly for goods and services. For example, a large part of the spending for education and social services in federal governments often consists of allocating grants among subordinate governmental jurisdictions rather than spending directly for the activities and projects required to supply the services needed. This alters, but does not invalidate, the application of performance budgeting to these categories of expenditure. In the case of direct expenditures by a federal government, such as those for military or transportation purposes, performance budgeting applies the same way that it does to the direct costs of any unitary government.

In federal nations grants are usually apportioned among political subdivisions on the basis of some measure of need in accordance with formulae which relate to factors such as population, area, wealth, or income, and characteristics which pertain to the basis of the grant such as miles of road, number of school children, or patients requiring hospitalization. In this situation, performance budgeting methods can be useful in providing: (1) a basis for allocating money among various subordinate governmental jurisdictions, (2) standards of work to be achieved by the expenditure of the money transferred through the device of grants-in-aid, and (3) a basis for measuring and comparing results accomplished by grants-in-aid. Even though the central government may not directly administer the activities and projects being financed by grants, it is to its advantage to apply rational and defensible criteria in apportioning such moneys and in evaluating the results achieved.

In addition to allocating moneys to subordinate governments on the basis of work to be accomplished or results to be achieved, it is important for the central government to be able to judge the effectiveness of the grants in terms of the general objective or purpose for which they were apportioned. Reports from the political subdivisions indicating the results accomplished with the money spent can give the central government a measure of the effectiveness of the grants in meeting the intended needs. These reports also provide the central government with performance data which can serve as a basis for reconsidering and possibly altering the basis for distributing future

grants. In addition, performance data can provide the central government with information which may be useful in understanding and evaluating differences among the various regions of the nation for purposes of planning for more effective national economic development.

Another important advantage of performance budgeting is to furnish information which will enable the central government to assess the comparative effectiveness of operating programmes at differeat governmental levels. Decisions to centralize or decentralize governmental operations can be made more rationally if there is a measure of the relative efficiency of the various governmental units for administering particular programmes. This applies especially to newly-formed or rapidly-developing nations where vast and increasing demands for new services and activities are being placed on government.

In the establishment and evaluation of grants-in-aid, programme effectiveness is, of course, only one criterion which must be weighed together with other factors such as: (1) the history and traditions of the nation and its government, (2) the need to stimulate economic growth more rapidly in particular areas, (3) the desire to reduce economic or social inequalities among various regions, and (4) the effect on the longer-range design or plan for future national development.

Limitations

Every new methodology has limitations, and performance budgeting is no exception. Many of the limitations of performance budgeting, however, relate to certain misconceptions which have arisen over this comparatively new approach to budgeting.

Performance budgeting offers no panacea to the problems of budget administration. Effective budgeting requires good judgement, an understanding of human and social values, sound decisions, and the best intent on the part of the decision maker. No technique or methodology can possibly substitute for these important requirements. However, by developing data and information in a form which is useful for decision-making and which gives a rational support for the judgments and choices made, performance budgeting can be an extremely valuable tool for the guidance of those who have the responsibility for making governmental policy.

It should be emphasized again that performance budgeting does not apply uniformly to the entire budget. Instead, it pertains most usefully to particular parts of a budget—called activities or projects—which form the building blocks upon which the total budget is ultimately built. Performance budget techniques help to provide a base for informed and intelligent decision-making among alternatives which are either similar or somehow measurable in relation to each other. This

approach to budgeting facilitates, for example, the comparison of hospital service unit costs among a number of different hospitals or provides data on the number of students enrolled at various schools in terms of cost per student. Similar activities or projects can thus, be compared in terms of their productivity, effectiveness, and cost. In the same manner, changes in the productivity and cost of a single activity may be compared over a period of time.

Performance budgeting, however, has less direct applicability in comparing activities or projects of very different natures. It is not possible, for example, to compare directly the value of a school with the value of a new public health programme, or compare either of these with increased military expenditures, or evaluate these activities with the need for spending money on modernizing a road network. To the extent that unit costs of unlike activities are not directly comparable, the usefulness of performance data may be somewhat limited.

It is important to understand, however, that performance budgeting does provide a better basis for making decisions concerning the allocation of resources among dissimilar activities, even though there is no direct comparability among the output units. Cost per unit does provide a common denominator for making comparative judgments. By being able to compare the cost of educating a child with the cost of inoculating a village resident against diseases and the cost of building a mile of road, policy makers are better able to establish relative priorities and to establish a basis for budgeting resources among needs. While the comparative values of providing these different services must be weighed in relation to various other factors already mentioned, the basic data and information produced to explain each cost in terms of results accomplished is highly useful to the final decision.

Another limitation attributed to performance budgeting is that it measures quantity but not quality. The chief value of performance data is to facilitate judgements by providing information which may be used to support certain decisions over others. Qualitative differences are sometimes difficult to detect and account for. Work units must be scrutinized carefully to identify and explain different levels of quality and other distinguishable characteristics which may make comparison of unit costs misleading in terms of effectiveness or production of work. This is one of the greatest problems in the application of performance budgeting. For example, while the cost of daily hospital care per patient at hospital A may be 50 per cent higher than at hospital B, it does not necessarily follow that hospital B is being run more effectively than hospital A. The quality of care at hospital A may be superior so that the average patient stay, and the ultimate cost per patient, is considerably less than at hospital B, or

hospital A may simply be in an area where prices of goods and services are higher.

There are, of course, many other differences which quantitative data produced by performance budgeting do not explain. Comparative money costs in themselves do not give sufficient indication of programme effectiveness. Unit costs must be studied to ascertain the reasons for differences before judgments are made. In spite of this limitation, performance data provide a basis of comparison which, although not final, illuminates differences so that further investigation can reveal the reason for the differences and enable the administrator or the politician to make a better informed judgment than if no data were provided.

Performance data are useful in establishing norms for various types of activities and projects. Although these norms are not static and are not applicable to all situations, they do indicate a general average or tendency. Any particular activity or project which deviates from the established norm should be examined more closely to determine the reason for the deviation. If a number of activities or projects begin to show substantial deviations from the norm, then the norm should be reviewed and perhaps adjusted. In many cases the norm is best stated as a range rather than as a point in order to allow for seasonal and other variations.

Still another criticism of performance budgeting is that it tends to produce over-specialized information and that the effort in producing performance data may tend to overshadow the usefulness of such data. This argument has validity only to the extent that it is true in practice, and in those cases performance data either should not have been collected, or more likely, the data should be used more intelligently. It is wasteful to produce any data which are not useful.

One aspect of performance budgeting which is often overlooked is that its installation requires much work and study over a fairly long period of time. The effectiveness of this approach to budgeting depends upon the manner in which it is applied and used. Standards can be set only after considerable analysis and understanding of programmes, and these standards must be subject to continuous review and re-evaluation. Data must be constantly refined, policies re-considered in the light of new developments, and the applicability of unit costs continuously tested on the basis of changing conditions.

SUMMARY

Performance data provide a common language for communication of information among agencies of a single government, between agencies of central and subordinate governments, and even between nations

since many activities are common to different governments. These data form a common frame of reference for administrators and for politicians by providing a valuable tool for analysis and comparison of results achieved. The use of performance budgeting encourages work improvement through work measurement and the subsequent systematic reporting of results in significant, meaningful terms.

Performance budgeting applies equally, although somewhat differently to grants-in-aid and to direct expenditures. The responsibility for the central government to allocate grants on a just and rational basis is as great as if it spent the money directly for the services, as in the case of unitary national governments. The same need for assigning relative priorities to various programmes exists whether these programmes are executed directly by the central government or are administered through grants to subordinate governments.

Performance budgeting is a new approach to decision-making and reporting in governmental budgetary processes. In itself, it does not solve problems, but does provide useful and valuable guidance if used properly. Many of its so-called limitations are based on misconceptions of its purpose and use. The grand budgetary decisions at the highest policy levels depend upon political, economic, and social judgment, and it is hardly likely that choices among such competing values will be made solely on a statistical or quantitative basis. However, the application of performance budgeting methods to the largest aggregate to which technical judgments can be used gives a good base upon which to make broader value judgments and provides the chief policy makers with support for their decisions. By linking physical progress to fiscal effort, performance budgeting can provide useful measures of the success of development planning and administration. □

The Comptroller and Auditor-General and Public Enterprises in India*

Laxmi Narain

OUR COMMITMENT to a socialistic pattern of society adds vastly to the importance of public enterprises. They are destined to play a crucial role in the country's economy in the years to come. The efficiency and economy with which they are managed naturally concern all of us. Of equal importance is the need for an impartial body to judge their working and to report on their achievements and failure.

Audit is one of the important instruments of control and accountability, and more so when put in the hands of an independent public authority—the Comptroller and Auditor-General, hereinafter referred to as the C&AG. This article aims at discussing the nature and effectiveness of this method of control. The existing legal provisions in this behalf, in their historical perspective, are first described.

II

The organisational pattern broadly governs the type and method of audit in Indian public enterprises. If they are run departmentally like the Chittaranjan Locomotive and ordnance factories, the accounts are subject to conventional government audit. The accounts of the enterprises registered as government companies are audited by professional auditors (chartered accountants) (appointed by the Central Government on the advice of the C&AG. Till recently, the procedure for appointment used to be that the company forwarded the name or a panel of names of the auditors to the Government of India. The latter sent it for approval to the C&AG who almost invariably accepted the company's suggestion. In very few cases where it was not accepted by the C&AG the reasons mostly were that either the auditor had been too long with the company, or he had already appointments in other government companies.

At present, the auditors to be appointed are not suggested by the company concerned, nor by the government. The government forwards to the C&AG the names of the companies in which auditors are to be appointed. The C&AG then recommends the name of

*From *Indian Journal of Public Administration*, Vol. IX, No. 1, 1963, pp. 74-87.

the auditors to be appointed in each of the enterprises. The government can ignore this advice, but so far no such instance has occurred.

In public corporations diverse audit provisions exist. The Damodar Valley Corporation Act provides that the accounts shall be audited in such manner as may be prescribed in consultation with the C& AG. Under the rules framed under the Act, however, the Central Government has provided that the audit shall be conducted by an officer of the C&AG A later amendment to the rules has provided that the accounts so audited must be countersigned by the C&AG.[1]

In the Industrial Finance Corporation Act, 1948, audit was entrusted to 'not less than two auditors' appointed by the Central Government. By an amendment in 1952, only one of the two auditors was to be appointed by the Central Government *in consultation with the C&AG* and the other elected by the institutional shareholders of the Corporation. The Central Government's power of giving directions to the two professional auditors requiring them to report upon the adequacy of measures taken by the Corporation for the protection of its shareholders and creditors, or on the sufficiency of their audit procedures was also to be exercised in consultation with the C&AG[2]. In addition, the C&AG was given a right either on his own motion, or on a request from the Central Government to undertake such audit and at such times as he considered necessary. Another provision made was that if the Central Government was called upon to pay any subvention on account of its guarantee of the Corporation's loans, the C&AG shall undertake the Corporation's audit.[3]

The above provisions were not discussed in any detail at the time they were introduced through an amending Bill. The justification for the amendment given by Shri M.C. Shah, the then Deputy Minister of Finance piloting the Bill was that it brought the Industrial Finance Corporation Act in line with the State Financial Corporations Act, 1951, which contains similar provisions. The Deputy Minister also disclosed that the amendment was in accordance with the wishes of the Public

[1]*Gazette of India*, 27th December, 1952, Part II, Sec. 3. The Public Accounts Committee, in their Reports on the Accounts for 1947-48 (post-partition), have observed: "As regards the audit of other corporations financed either entirely or partly by the Central Government, we share the views held by the C&AG that his functions and responsibilities should be defined in explicit terms in the statute itself providing for the setting up of a Corporation." p. 5.

[2]*Industrial Finance Corporation Amendment Act, 1952*, Sec. 24.

[3]*Ibid*. The Accounts of the Corporation for the year ended June 1954 were for the first time audited by the C&AG as empowered by this Section. At that time the Corporation was receiving a subsidy from the government. Since the year ended June 1957 no subventions on account of guarantee have been received from the government, but audit by the C&AG continues, perhaps because earlier subventions have not yet been returned in full.

Accounts Committee.[4]

There was hardly any discussion on the audit provisions of the State Financial Corporations Act which inspired the above amendment except that Shri A.C. Guha, M.P., made an unsuccessful attempt to the effect that both the auditors, which the Bill provided, should be appointed by the C&AG. He expressed an apprehension that "the shareholders may put some convenient auditors".[5]

The propriety of appointing auditors on the basis of the interest they represent is open to question. If an auditor is appointed by the government as a shareholder and the other by the rest of the shareholders, both being qualified chartered accountants, should there be difference in their approach to the work? Are not both expected to audit according to the well-established traditions and practices of the profession? The auditor is an impartial expert who protects the shareholders' interests in general. No distinction therefore need be made between the two sets of auditors appointed to carry out audit. In any case, when the government considers it necessary, it can exercise its power of using direction to the auditors, in consultation with the C&AG under the Act, regarding the way in which audit is to be carried out.

In the Rehabilitation Finance Administration, incorporated in 1948, the C&AG was not entrusted with power to audit; professional auditors were to be appointed by the Central Government.[6] But as a part of the systematic extension of the C&AG's audit control to public enterprises, the Rehabilitation Finance Administration Act was amended in 1953 and the C&AG replaced professional auditors.[7]

In the case of Reserve Bank Act, 1934, an amendment made in 1948 provides that the accounts shall be audited by not less than two auditors appointed by the Central Government.[8] The Central Government is also empowered to appoint the C&AG to examine and report upon the accounts of the Bank. The provision, however, seems to be formal safeguard and has not been invoked in practice so far. The three chartered accountants appointed by the Central Government, who have remained unchanged since 1948, have been submitting a

[4]During the debate on the amendment, Dr. M.M. Das, who was then a member of the P.A.C., disclosed that the Committee had reached a unanimous decision about the C&AG's jurisdiction over the Corporation. He added that the "Auditor-General himself approved this decision of the PAC" and "the government was informed about this decision", *Lok Sabha Debates*, 5th December, 1952, col. 1649.

[5]*Lok Sabha Debates*, 28th September, 1951, col. 3664.

[6]*The Rehabilitation Finance Administration Act, 1948*, Sec. 16.

[7]Rehabilitation Finance Administration (Amendment) Act, 1953. This Corporation was wound up in 1957 by the Repealing and Amending Act, 1957.

[8]*The Reserve Bank of India (Transfer to Public Ownership) Act, 1948*, Sec. 7.

routine and formal report, without any comments year after year.

When the nationalisation of air transport was being discussed by Parliament in 1953, the opinion had more or less been changed in favour of the C&AG. Not much discussion therefore took place on the audit provisions or the Air Corporations Bill which provided that accounts of the two air corporations shall be audited by the C&AG.[9] The Air-India, however, in addition, gets its accounts audited by two firms of auditors "in accordance with the generally accepted auditing standards applicable to joint stock companies". The reasons given by the Air-India are: First, the C&AG is not obliged to complete the audit of the Corporation's annual accounts and to issue certificate on which the Board of the Corporation could rely to enable the Board to adopt the annual accounts and submit it to the Central Government within the time stipulated, and secondly, the Boeing Loan Agreement contained a provision for the submission of a periodical statement of accounts by the Corporation duly certified by the chartered accountants satisfactory to the banks.[10] According to Rule 6 of the Corporation it has to submit its accounts duly passed by the Board to the Central Government and the C&AG by 31st August every year. The Corporation perhaps does not feel confident to do so unless its accounts have been audited by qualified auditors. The Indian Airlines Corporatian does not follow this practice.

When the C&AG carries out a full-fledged audit of the Air-India International, the need to appoint private auditors may be questioned. As in the IAC, the Air-India International also could develop a strong internal audit department to avoid the present duplication. As regards the Corporation's second argument, it may be noted that professional auditors were there even before the Boeing Loan Agreement.

The State Bank of India Act, 1955 provides for the appointment of two qualified auditors by the Reserve Bank in consultation with the Central Government. In addition, the Central Government can appoint "at any time such auditors as it thinks fit to examine and report on the accounts of the State Bank".[11] When the State Bank of India Bill was under consideration in the Lok Sabha, Shri B. Das, a senior member of the House, felt strongly on the question of audit, and remarked : "I got the surprise of my life when in the year 1955 in clause 41[12] (which dealt with audit) there is no desire to mention the

[9]*The Air Corporations Act, 1953,* Sec. 15(2).
[10]*Thirty-fourth Report of the Estimates Committee* (Second Lok Sabha), p. 39.
[11]*State Bank of India Act, 1955,* Sec. 41 (1) and 41 (9).
[12]This is now Section 41 of the State Bank of India Act.

name of the Auditor-General".[13] He reminded the Minister (Shri A.C. Guha) that in other financial corporations, *viz*., the Industrial Financial Corporation and the State Financial Corporations, the C& AG had been given a hand. The Minister's reply to this was naive and weak. He said: "Every one of the Auditor-General's reports is placed on the Table of th: House and is liable to be debated...The State Bank will continue to be the biggest commercial bank of the country giving credit not only to other scheduled banks but also to industrial and commercial concerns. In these circumstances it is not quite prudent to lay all its reports on the Table. There may be some defects also; I do not claim that there will not be any defects or deficiencies, but still if we accept the function of this Bank as that of the biggest commercial bank of the country we cannot take that risk." He conveniently overlooked the fact that the Industrial Financial Corporation and the state financial corporations were also in the nature of banking institutions. To Shri B. Das's Interruption that "You cannot evade the constitutional position", the Minister boldly replied: "That may be a point for the Supreme Court."[14]

At the time of the clause-by-clause discussion, an amendment was introduced to the effect that the auditor be appointed by the C& AG and not by the Reserve Bank, but it was lost.[15] Similarly, another amendment negatived was that the Centre's power "to appoint such auditors as it think fit" should specifically be mentioned to include the Auditor-General.[16]

A year later when the Life Insurance Corporation Bill was before the Lok Sabha, there was a major controversy on the issue of the C& AG's audit control over the Corporation. The Minister, Shri C.D. Deshmukh, who piloted the Bill, had to face a rough time in keeping the C&AG at arm's length. The minister was in difficulty, particularly because, in the past, at his own instance, the C&AG had found a place in the statutes relating to several public corporations, and in the law dealing with government companies. He had no convincing answer to the question repeatedly thrown at him: Why other commercial and business enterprises were put under the C& AG's jurisdiction? His argument was that "the enterprises like the

[13]*Lok Sabha Debates*, 23rd April, 1955, col. 6135. Shri B. Das had been agitating for the nationalisation of the Imperial Bank for a long time and as such was given the first chance to speak on the nationalisation bill.

[14]*Ibid*., col. 6390. It is interesting to note that when Shri A.C. Guha was not sitting on the Treasury Benches his views about the powers of the C&AG in relation to public enterprises were different. (See. p. 76 *ante*).

[15]*Lok Sabha Debates*, 30th April, 1955, col. 7167.

[16]*Ibid*., This amendment was introduced by a Communist member, Shri Sadhan Gupta. There was no discussion on the motion.

DVC, IFC., Air Corporations and government companies function more or less under governmental conditions". He also took the help of arguments of maintaining *status quo* in the Corporation's working, and of the shortage of staff with the C&AG.[17]

Shri C.D. Deshmukh discounted the main fear expressed by the MPs. that denying the C&AG's jurisdiction would affect parliamentary accountability. His appeal was: "You could always add later, if you find the present system does not work." And finally the emotions were brought into play. The minister felt "terrified of the wisdom and hindsight" of the C&AG. He went on to disclose: "When I took the initiative in suggesting nationalisation of life insurance, to my colleagues in the Cabinet I said that if the affairs of the Corporation, or whatever we might establish, were going to be audited by the ordinary audit machinery, then I would not recommend the nationalisation of life insurance."[18]

The impression of an unjustifiable extension of the Auditor-General's control along with Dr. Paul H. Appleby's scathing and assailing criticism of the Auditor-General[19] (a reference to it was made by him during the debate) might have influenced the minister's thinking on the subject. The minister fought and won against the C&AG. The clause regarding audit, was not finally amended to bring in the C&AG's audit. The impression[20] given was that the question was being fought more on prestige than on merit, though it could be fought on merit as well.

The above discussion indicates how a systematic effort has been made by Parliament to extend the jurisdiction of the C&AG to all public enterprises. The criticism that was levelled by the C&AG, Shri Narhari Rao, that government companies were a fraud on the constitution because, *inter alia*, the C&AG had not been given a statutory right to audit government companies has been met by the amendment of the Companies Act in 1956, which provides that the C&AG shall have a right: (*a*) to direct the manner and to give

[17] *Lok Sabha Debates*, 21st May, 1956, cols. 9073, 9078.

[18] *Ibid.*, col. 9078. From the official records it appears that while speaking about the C&AG the minister's remarks had to be expunged at three places. It is therefore difficult to gauge the emotions intermingled with the issue *Lok Sabha Debates*, 22nd May, 1956, col. 9223.

[19] Paul H. Appleby, *Re-examination of India's Administrative System with Special Reference to Administration of Government Industrial and Commercial Enterprises*, Cabinet Secretariat, Government of India, New Delhi, 1956, pp. 27-9.

[20] One of the events which created such an impression was a note circulated by the C&AG to some Members of Parliament in support of his claim to audit the accounts, of the L.I.C. (Lok Sabha Debates, 1956, Appendix XIV, Annexure 32). The Minister, Shri C.D. Deshmukh, took a strong exception to the circulation of this note. (Vide *Lok Sabha Debates*, ...22nd May, 1956, col. 9223).

instructions about the way the accounts shall be audited, (*b*) to conduct a supplementary or test audit, (*c*) to comment upon or supplement the audit report which was to be submitted to him by the auditors, and (*d*) to advise in the matter of appointment of auditors.[21] Similarly, the anxiety of the Members of Parliament that the accounts of the public corporations should be audited by the C&AG or at least in the matter of appointment of auditors, the C&AG should have a say and that he must have the right to comment upon the audit conducted by such auditors—has been largely met except in the case of Life Insurance Corporation and the State Bank of India.

Dean Appleby attributes desire to extend the control of C&AG to Parliament's 'greatly exaggerated notion' of the importance of auditing and of "parliamentary responsibility". Parliament, he says, has given 'unselective attention' to what he calls "the pedestrian function of auditing". He charges Parliament for not defining the functions of the C&AG, as the Constitution contemplated it would do resulting in "Into the vacuum thus left, the auditor (C&AG) has moved."[22]

Whether this criticism is justified or not, it is true that because the C&AG occupies an important position[23] in the Public Accounts Committee, Parliament has a very favourable attitude towards C& AG's audit. Serious financial irregularities in some public enterprises have further accentuated Parliament's desire to extend C&AG's audit to public enterprises.

III

Let us now examine the content of the C&AG's audit of public enterprises and the manner in which it is conducted.

[21]It is important to note that the original language in the Bill regarding appointment was "after consultation with" the C&AG but it was charged to "on the advice of the C&AG" on a private member's motion. (*Vide Lok Sabha Debates*, 8th September, 1955, cols. 12990-12999.)

[22]Paul H. Appleby, *op. cit.*, p. 29. Appleby's reference to the Constitution relates to Article 149. This Article states: "The Comptroller and Auditor-General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any Law made by Parliament...." Parliament, it may be noted, has not yet moved in the matter even though the matter is under consideration since 1958.

[23]Very much unlike his counterpart in the UK, the C&AG in India "continuously holds consultations with the Chairman as the evidence is proceeding and very frequently asks questions from the departmental witnesses and also makes comments and observations in the course of such evidence". S.L. Shakdher, "Comptroller and Auditor-General of India and the UK—A Comparison", *The Indian Journal of Public Administration*, Vol. IV, No. 4, p. 407.

It is important to note that auditors of the C&AG's office generally insist on reporting whatever does not fit within its mould of rules, regulations and procedures. Nowhere audit manuals and instructions give discretion to the audit staff to attach lesser weight to lapses of procedure or regulations if the enterprise is being administered efficiently.[24] The auditor would argue; it is no part of his duty to pass a verdict or give a judgment about an enterprise, it is for the Public Accounts Committee or Parliament. He collates and analyses facts as fully as possible and invites Parliament's attention to them. Not only that audit objections are mostly petty and formal often a presumption of *mala fide* is made simply because a particular procedure has been circumvented to meet the exigencies of a situation.

This approach is bound to do great harm to a live business organisation. Business means taking delicate decisions, some of which must go wrong. No individual in business would like to be hauled up before a parliamentary committee and explain the correctness of a decision taken years back, probably by his predecessors, in altogether different conditions and circumstances. As the C&AG's reports attract great attention from Parliament and the public, much damage could be done even by small matters.[25] While caution and care must be exercised, there is always a point beyond which the price to be paid for excessive caution becomes disproportionately high. People and Parliament will therefore have to be educated to be tolerant of minor errors if an enterprise has on the whole made a success; while being intolerant of failure to achieve the specified goals.

A good deal of the criticism of C&AG audit also arises because

[24]The Audit Department's view is that many of the rules, regulations and procedures which audit has got to follow are laid down by the administration. Government has rules of procedure for financial controls, many of which persist from the colonial days and are based on the philosophy of distrust of the individual. These rules have got to be followed even though outmoded and, in many cases, meaningless. But the blame for the results is shifted to audit. The present C&AG told the writer that audit people are completely helpless about many of the rules of procedure laid down by the administration. And even the C&AG's efforts to get frustrating rules changed may not always be successful.

[25]It is necessary to state that audit objections do not just go before the PAC and Parliament. In addition to the discussions and exchange of views in the course of audit, before the final report is submitted to the enterprise, it is discussed in the appropriate ministry at a high level, the participants being the ministry officials, the C&AG staff and the enterprise. Some of the more important observations of the C&AG on various public enterprises form part of his report to Parliament which is looked into by the PAC. Thus, the number of objections which reach Parliament are very few as compared with the total objections raised by the C&AG staff in various public enterprises.

it is claimed to be an efficiency-cum-propriety audit.[26] For this purpose it probes into the decisions taken by the Board of Directors. Dr. Paul H. Appleby questioned this and also objected to the instructions of the C&AG regarding the audit of public enterprises which state "the audit by the C&AG will be generally directed towards a review of the decisions taken by the board of directors to ascertain to what extent their powers have been exercised in the best interest of the undertakings."[27] About these instructions he challengingly asks: "What special competence for appraising objectives and appraising administrative performance in general has the C&AG? What is the Cabinet for, what is the Prime Minister for, what is Parliament for, what are the individual ministers for, what is a Secretariat for, and what is a bureaucracy for?"[28]

Even assuming that it is proper for the C&AG to conduct efficiency-cum-propriety audit, experience has shown that even with its modern slant on managerial assessment, audit can only look into managerial efficiency so far as it is reflected in the financial results of an enterprise's working. Audit of accounts, however widely interpreted, is incapably of evaluating technical efficiency.[29] An auditor, for instance, cannot comment upon the alternative courses of business decisions in regard to investment in factors of production, or whether the technical efficiency of the means of production is at its optimum. Similarly, an auditor is not competent to review specific management decisions.

The C&AG in India in this regard suffers from an additional drawback, *viz.*, that he does not have adequate qualified personnel. The Commercial Audit Department of the C&AG's organisation is staffed largely by those brought up in government audit tradition.

[26]According to the present C&AG, his audit evaluates only financial efficiency as distinct from any other efficiency. But it is not quite clear what the financial efficiency will cover.

[27]Paul H. Appleby, *op. cit.*, pp. 28-9. These instructions were issued by Shri Asok Chanda. The present C&AG. Shri A.K. Roy, does not agree with them.

[28]*Ibid.*, p. 29.

[29]Sir Frank Tribe, a former C&AG of the UK, in his evidence to the Select Committee on Nationalised Industries, said: "I could undertake the audit of public corporations, although I do not want to, but I would like to make it quite clear that, if I were to be charged with this duty I should certainly not claim that I could undertake an efficiency audit. I think there is a lot of misconception about this. I do not believe myself that any examination of a board's accounts can even lead to a right judgment upon the efficiency as such of the organisation itself....I believe certain accountants in America do claim to do that kind of (efficiency) accounting, but... they have on their staff experts in personnel management and other types of efficiency, including often technical engineers and other technicians, and then they make a comprehensive report on efficiency, only part of which is related to the accounts." Report of 23rd July, 1953, HMSO, Evidence, Q. 136, p. 16.

They find it difficult to adjust themselves to differing circumstances of public enterprise audit. A proper reorientation of their outlook has not yet taken place. Further, the audit parties deputed to various public enterprises are so often changed that they lack proper perspective of the enterprise's operations.[30] As their conclusions are based on insufficient knowledge of the organisation, these are taken lightly and even ridiculed by persons with the inside knowledge of the organisation's working. The audit staff thus unnecessarily gives an impression of being "bloodhounds" rather than the "watch-dogs" which they are supposed to be.

In the U S Government corporations are audited by the Comptroller-General. But the Corporate Audit Division of the Comptroller-General's Office is largely manned by professional auditors. The standards for audit by the Comptroller-General conform to those adopted by the American Institute of Accountants and his offices conduct audit in a manner comparable to any large independent public accounting organisation.[31] If the C&AG's audit is to serve a more useful purpose, the need would be to strengthen its staff by recruiting persons from the profession, and of giving them suitable training.[32] Refresher courses would also be necessary for the existing staff to acquaint them with the ins and outs of the operation of state commercial and Industrial enterprises.

IV

A special feature of the Government company audit requires to be noted here. Section 619(3) (*a*) of the Companies Act empowers the C&AG to direct the manner in which the Company's audit shall be conducted and to give instructions in regard to the audit of government companies.[33] In 1959, the government wrote to the C&AG

[30]For instance, in the Indian Airlines Corporation, within a period of eight years, more than half a dozen important changes in the personnel of the C&AG staff, which is supposed to be permanently posted there, have taken place. The attempt of the C&AG, it is stated, is, as far as possible, to send the same audit party to an enterprise for a reasonably long period. But there are practical difficulties of synchronising the time of audit with the availability of the staff.

[31]*Rcport on Management Accounting*, submitted to the Council of the Institute of Chartered Accountant of India, New Delhi, 1958, pp. 128-29.

[32]At present the Indian Audit and Accounts Service probationers are provided with a ten-week practical training in some firm of chartered accountants.

[33]Sec. 619(3) (*a*) states: "The C&AG shall have power to direct the manner in which the company's accounts shall be audited by the auditor appointed in pursuance of sub-section (2) that is, on the advice of the C&AG of India, and to give such auditor instructions in regard to any matter relating to the performance of his functions as such."

to explore the possibility of giving direction under the law. But the C&AG took no action in the matter. Later, a Cabinet direction was given to the C&AG to exercise his powers under Section 619(3)(*a*). Eventually in March 1962, a direction was issued to all the auditors of government companies, The object is to make audit 'more fruitful' and "to provide useful data for a correct appreciation of the public enterprises' financial operations."[34].

By this direction, professional auditors, among other things, have been asked to comment upon the system of accounts, internal control and costing. They are to calculate : (*i*) return on capital invested, (*ii*) ratio of closing stock to net sales, (*iii*) ratio of net profits to net sales, (*iv*) ratio of current assets to current liabilities, and (*v*) ratio of cost of sales to net sales. The auditors would now give their opinion about the adequacy of financial provisions for the maintenance of plant and machinery, and about the effectiveness of the system of procurement and disposal of stores. The auditors are now also expected to look into the basis of fixing the selling prices of the products of the company, and how such prices compare with the cost of production.[35]

It is pertinent to ask: What remains for the C&AG's staff to do when the professional auditors carry out the above function, besides their own routine checks? It is argued that when these instructions will be put into effect, there may be no occasion for the C&AG to conduct a test or supplementary audit (which is said to be efficiency-cum-propriety audit) as contemplated by Section 619 (3) (*b*). In fact, a very senior official of the government disclosed,[36] that when the audit provisions in Section 619 of the Companies Act were being drafted in consultation with the then C&AG, Shri Narhari Rao, it was never thought that the test or supplementary audit would be carried out in every case. It is, therefore, hoped that this power would be more of a formal nature and used sparingly. Shri Asok Chanda has suggested that an independent audit by the C&AG should be invoked "only where the normal audit reveals gross mismanagement,"[37]

It has been suggested that if the C&AG voluntarily spares the government companies of his test or supplementary audit, particularly when professsional auditors are appointed on his advice, and he directs their audit, it would relieve them from much inconvenience. This would not in any way mean abandonment of his audit control because under Section 619 (4) he would still continue to comment

[34]Audit Report (Civil), 1962, p. 114.

[35]For a complete list of aspects required to be attended to by the commercial auditors, as per the directions issued by the C&AG., referred to earlier, see *Annexure*.

[36]The officer concerned would prefer to remain anonymous.

[37]Asok Chanda, *Indian Administration*, Allen & Unwin, London, 1958, p. 202.

upon their reports.[38] It is important to note that even at present his reports on government companies are under Section 619 (4) and not under Section 619 (3) (*b*)[39] and in majority of the cases no comments are made by him on the professional auditors' reports' [40].

V

In conclusion, dogmatism of any kind should be avoided about the C&AG's audit of public enterprises. All the world over, in varying measures there is a shift from autonomy to control over public enterprises and there is least doubt that the C&AG's audit is an important instrument of this control. What is necessary, therefore, is not to do away with the C&AG's audit, but to regulate the form, content and approach of his audit so that it may be carried out with the least damage to business efficiency of public enterprises. An important change would be to lay much greater emphasis on the assessment of the results rather than on the meticulous implementation of the rules and procedures. As regards the failures or mistakes, the effort should be to suggest ways and means which will lead to the avoidance of abuse or irregularity in the future. Further, audit report should be oriented in a positive way so as to lead to purposive action.[41] It is necessary to allow greater discretion to the audit staff to decide the seriousness and implications of a default on the spot. This is only possible if the staff are competent, experienced, and sufficiently senior.

Pay scales of the staff entrusted with the audit of public enterprises would also have to be enhanced to recruit and retain sufficient number of persons of the requisite qualifications. Only a properly trained

[38]Section 619 (4) reads: "The Auditor aforesaid (the auditor appointed on the advice of the C&AG) shall submit a copy of his audit report to the Comptroller and Auditor-General of India, who shall have the right to comment upon, or supplement, the audit report in such manner as he may think fit."

[39]Section 619 (3) (*b*) reads: "The Comptroller and Audit-General of India shall have power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to any person or persons so authorised on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order, direct."

[40]Out of 36 reports or more important government companies for the year 1960-61, no comments appear in 24 cases. The usual pattern being: "I have to state that there are no comments upon or supplementary remarks to the auditor's report under sub-section 4 of Section 619 of the Companies Act on the account of.........Ltd. for the year ended............".

[41]The latest audit report on civil appropriation presents a marked improvement over earlier reports. See Chapter VIII, Government Commercial Undertakings, Audit Report (Civil) 1962.

audit staff, imbued with the sense which pervades any well-organised, purpose-conscious, and efficient business organisation, could remove the stigma of 'fusy about frivolities' attached to government audit.

It is heartening to note that both the C&AG and the Director of Commercial Audit (officer directly in charge of public enterprises audit), whom the writer met, recognise the need for improvement in their department. They feel that such improvements are in the making. Their approach is definitely progressive and positive. There is appreciation of the point of view of public enterprises and a recognition of their own shortcomings. This progressive and enlightened outlook at the top is bound to be reflected at the lower levels in the course of time.

Annexure

List of aspects required to be attended to by the auditors, as per directions issued by the Comptroller and Auditor-General under Section 619(3)(a) of the Companies Act, 1956

I. System of Accounts and Book-Keeping

1. Has the Company issued appropriate instructions laying down the respective duties and responsibilities of various officers in regard to the maintenance of accounts? Does the auditor consider, on the basis of test checks exercised, that the accounting system is adequate for purpose of preparation of final accounts as well as for purpose of "auditing in depth" which involves tracing transaction through its initial to final stage? If not, what are the main deficiencies?

2. Are the books of account and the accounts records properly maintained up-to-date? If not, the deficiencies may be pointed out.

The auditor may indicate when the final draft of the accounts is given for audit.

3. In regard to a company with subsidiary units or branches, does the Head Office maintain proper control accounts of branches? Is there any drawback in the system of control accounts maintained?

4. Is the allocation of expenditure during construction between Capital and Revenue properly done so that the cost of an identifiable unit of plant (*e.g.*, coke oven in steel plant) can be ascertaindd? If not, the defective cases should be indicated.

II. Interal Control

1. Has the Company issued adequate instructions indicating the financial powers of heads of branches and their subordinates? Does the procedure provide for adequate financial checks and safeguards?

2. Is there an internal audit system? Are you satisfied that the important points thrown up by the internal audit have been considered by the administration and necessary action taken? If not, indicate the more important points on which consideration/action is outstanding. Have any drawbacks in the system come to your notice?

3. Does the Company prepare the budget for a financial year with adequate details sufficiently in advance? If so, the actual performance in regard to control over revenue and expenditure in relation to budget provision may be indicated.

III. Manufacturing and Production Accounts

1. Does the Company maintain periodical quantity accounts of production of the major products? How do these compare with the periodical targets fixed?

2. Does the Company prepare accounts indicating the cost of a unit of its major products? Have you any general comments to make on the effectiveness of the system of cost accounting?

3. Are records maintained for determining the rejections in production? Have you noticed any abnormal variations?

IV. Profit and Loss Account

1. On what basis are the selling prices of various products of the Company fixed? How do they compare with the cost of production?

2. Has adequate financial provision been made for maintenance of plants and machinery? Are there stand-by plants? If so, how far are they worked during the year as ascertained from the records of the Company?

3. Has the company obtained any waiver or moratorium of interest on loans obtained by it from government or others? To what extent has the Profit and Loss Account of the year been affected by such a concession?

V. Balance Sheet

1. What are the total volume of book debts during the last four years as on the dates of the respective balance sheets? What are the amounts of debts outstanding for more than one year?

2. Does the system of procurement and disposal of stores ensure that: (*i*) stores much in excess of the reasonable requirements of maintenance and production are not accumulated; (*ii*) the amount of; (*a*) surplus, and (*b*) unserviceable stores are periodically determined; and (*iii*) surplus and unserviceable stores are disposed of the systems?

VI. General Review

1. What is the ratio of long-term loan advanced to the Company to the paid-up Capital?

2. What is the return on Capital invested (Share Capital, long-term loans and free reserves) during the last four years?

3. What is the: (*i*) ratio of closing stock to net sales, (*ii*) ratio of net profit to net sales, (*iii*) ratio of cost of sales (goods) to net sales, (*iv*) ratio of current assets to current liabilities over the four years ending with the year's accounts which are audited?

4. What are the subsidies/grants paid during the last five years by Government to the Company?

5. What is the trend of maintenance cost of Service units for the benefit of the staff during the last four years? Are *proforma* accounts maintained in respect of their operations? If so, what are the results?

VII. General

1. Have you any other observations to make in regard to the accounts of the Company of the financial working?

Management Accounting in Government*

K.L. Handa

THERE IS hardly any activity of an organisation, having financial bearing, which is not reflected in its budget. Funds need to be provided in the budget for the various activities the organisation plans to execute. An organisation's budget is a very important instrument for the planning, management and control of its activities. A proper planning and implementation of the budget would enable optimising the use of resources and economical achievement of the organisation's objectives.

The annual financial statement or the budget presented by the Government of India to Parliament every year is an accounting presentation that shows data by major and subsidiary account heads. The form of the accounts is prescribed by the President with the concurrence of the Comptroller and Auditor General, and is used as the basis on which budgets are prepared and presented to Parliament.

Management accounting can provide a highly useful service at both the stages of planning and implementation of the budget. It is based on information which can be obtained from accounts as well as on information not reflected in the accounts. It involves collection and presentation of all such information which can be of help in the preparation of a sound budget plan. Management accounting also implies monitoring and evaluation of performance of the activities as compared to the budget plan both in terms of financial expenditures and the corresponding physical accomplishments. Its purpose is to provide timely information to various levels of management to facilitate decision-making at these levels for the efficient and economical achievement of their tasks.

Whereas management accounting encompasses much more than mere financial accounting, the structure of accounts is of crucial importance inasmuch as it provides the necessary information for exchequer control and for monitoring and analysis of expenditures on programmes and activities. An understanding of the existing accounting classification is, therefore, essential to assess its utility as an important component of the system of management accounting.

*From *Indian Journal of Public Administration*, Vol. XXIV, No. 4, 1978, pp. 1060-73.

THE HISTORICAL BACKGROUND

The basic accounting structure in India dates back to the early years of this century and has remained, more or less, the same over the years. No major change took place in it until very recently (April 1974). There were some changes made from April 1, 1937 on the introduction of provincial autonomy, which, however, did not change the essential framework of the system. The classification and accounting structure had been evolved to subserve best the interests of financial and legal accountability of the executive to the legislature and, within the executive, of the spending agencies to the sanctioning authorities. The format of accounts had close correspondence with the departments or agencies collecting receipts or incurring expenditure. The classification of government transactions had a closer reference to the department in which the revenue or expenditure occurred than to the purpose of the revenue or expenditure. The basic concern was the item on which money was spent rather than the purpose served by it. Such a form of the structure of accounts served well as long as the main concern of the government was to ensure financial accountability and control. However, with a change in the role of the government, the need was felt for bringing in reforms in the structure of accounts to harmonize with the requirements of development administration.

In 1961, reforms were introduced in the accounting structure to facilitate improved analysis of governmental expenditure and to help the task of development planning. A few broad functional categories like social and developmental services and transportation and communications were provided having at the same time groupings like administrative services and contributions and miscellaneous adjustments.

RECENT DEVELOPMENTS

The demands for grants show, separately, plan and non-plan expenditure. Under the Indian planning system, the five years plans are framed in terms of functional categories, such as agriculture, animal husbandry, industry, transport, etc. Till recently, the groupings of schemes in the plan did not, by and arge, coincide with the major and minor heads in the accounts. Some sprinkling of functional categories in the budget was but of limited help in relating the plan and the budget. In view of all this, the Administrative Reforms Commission, while recommending the introduction of performance budgeting in India, also made suggestions for reforms in the structure of accounts. The Commission recommended that the structure of the major heads of accounts should be recast to reflect broad functions and major programmes of government. Also, the programmes, activities and projects

of the various departments and organisations should be clearly identified and the minor heads connected with these programmes suitably recast so as to reflect these activities. The Commission also suggested that the heads of development adopted for plan purposes should be reviewed with a view to establishing a direct correlation between these heads and the general accounting heads.[1] The Commission further recommended that the government should constitute a team composed of the representatives of the Comptroller and Auditor General, the Planning Commission, the Ministry of Finance, and the administrative ministry concerned, which should be assigned the task of drawing up a programme for the implementation of the Commission's recommendations.

The Government of India responded to the suggestion of the Commission by appointing a team of officers composed of the Deputy Comptroller and Auditor General, the Joint Secretary (Budget) of the Finance Ministry, and a representative of the Planning Commission, to undertake a review of the heads of accounts and the heads of development adopted for plan purposes[2]. The team has already submitted two reports.

The first report of the team submitted to the government in October 1971 deals with reforms in the structure of demands for grants. The report suggests that a ministry/department in charge of a number of distinct services may present a separate demand for each of the major services. The provisions relating to other miscellaneous functions/services under the charge of the ministry/department and those relating to its secretariat may be included in another demand. However, ministries/departments which administer only one major function or service may present only one composite demand covering all their requirements including provisions for the secretariat. In Part II of the demands, details of expenditure up to the level of major and minor heads of account may be included. A further break-up by each activity or scheme or organisation for which provision of funds in a year is Rs. 10 lakhs or more may be given for each minor head. All other activities/schemes/organisations under a minor head for which provision of funds in a year is less than Rs. 10 lakhs may be grouped together. The report also recommends that the plan and non-plan components of the provision for a minor head or for activities/schemes/organisations under a minor head should be shown distinctly in Part II of a demand. In Part III of the demands further details may be given about the provisions made in Part II for minor heads and for activities/schemes/organisations under minor heads. In the case of activities/schemes/organisations for

[1]Government of India, Administrative Reforms Commission, *Report on Finance, Accounts and Audit*, New Delhi, Manager of Publications, 1968, pp. 8-11.

[2]Government of India, Ministry of Finance, Department of Economic Affairs, *Resolution No. F. 1(65)--B/68, 22 March, 1969.*

which the budget provision is Rs. 10 lakhs or more, further break-up of the provision by objects of expenditure (establishment charges, travel expenses, etc.) should be given. Also, the plan and non-plan components of a provision for each sub-head should be shown distinctly. The team has recommended that in due course, performance budgets should be integrated with Part III of the demands. Also, according to the team, the expenditure on programmes, activities, schemes and organisations shonld be broken down and shown under the standard objects of expenditure or primary units of appropriation as suggested by the team in their report[3].

The team submitted a second report in November 1972 in which it included its recommendations on classification of government transactions in accounts and in the plan. It proposed a five-tier classification structure, *i.e.*, (1) sectoral classification to group the functions or services under broad sectors, such as general services, social and community services, economic services, etc., (2) major head classification representing the functions or the major divisions of governmental efforts such as defence, education, agriculture, etc., (3) minor head classification to identify the programmes undertaken under each function, (4) sub-head classification to reflect the schemes under each programme, and (5) the detailed head classification to reflect the expenditure on the schemes, in terms of inputs, such as salaries, purchase of stores, grants-in-aid, loans, investments, etc.

The team hoped that this classification structure would facilitate a purposeful review of the government operations by providing a link between budget outlays and functions, programmes, and activities. It would also ensure itemwise control of expenditure. Also, the proposed reforms in the structure of accounts would facilitate introduction of performance budgeting. The team further suggested that Planning Commission should undertake a review of the existing plan sectors and heads of development with a view to recast the plan suitably to bring them in line with the accounting classification.[4]

The Government of India accepted the recommendations of the team made in their two reports. The first report was accepted with effect from the year 1973-74. The suggestions made by the team in their second report were brought into effect from April, 1974.

[3]Government of India, "First Report of the Team on Reforms in the Structure of Budget and Accounts, on Demands for Grants of the Government of India", New Delhi, 1971.

[4]Government of India, "Second Report of the Team on Reforms in the Structure of Budget and Accounts on Classification of Government Transactions in Accounts and Plan", New Delhi, 1972.

THE NEEDS OF PERFORMANCE BUDGETING

In order to operationalise the concept of performance budgeting, it is imperative that the concept is also built into the structure of accounts. It is necessary that the budget classification in terms of functions, programmes, activities and projects, is supported by a similar classification in accounts.

Accounting is the basis on which the budget is framed. Therefore a suitable change in the classification of accounts should be considered as a pre-requisite for the introduction of performance budgeting. Accounts need to be function, programme, and activity oriented so as to speak in the same language as the performance budget. For instance, if medical relief is a function included in the budget classification, there must be a corresponding account head from which expenditure on the same function could be monitored.

Performance budgeting being predicated on the primacy of management function, it requires preparation of accounts in a form which facilitates monitoring and analysis of functions, programmes, activities, and projects. A functional classification of accounts under heads as correlated with the budget heads can prove of direct help to management.

In the conventional budgeting systems, conceived largely in financial terms, emphasis is placed on financial and legal accountability. The stress is laid on the observance of appropriation limits. The classification of accounts is, accordingly, evolved and developed mainly to satisfy the twin considerations of financial control and accountability.

In view of these objectives of a conventional budget, in India, the classification in accounts was structured so as to correspond to the organisation in which the transaction occurred and within the organisation to the inputs on which the expenditure was incurred. For example, construction of a hospital would be classified and displayed in accounts as public works expenditure and not as expenditure on a function like medical relief under social services. The classification indicated the nature of expenditure but not its purpose It did not enable identification of expenditure with functions, programmes, activities, and projects. It lacked the management approach in accounting in as much as it did not provide facility for monitoring and analysis of expenditure on functions, programmes, activities, and projects.

Also, the classification as developed did not provide any correlation between account heads and the plan heads of development. This created problems in getting information regarding progressive expenditure in respect of plan programmes, and made their evaluation difficult.

Accounting classification adopted by government should be such as would adequately serve its objectives. The various purposes required

to be served by accounts can be grouped under management and accountability functions. Whereas the management function can be served best by classifying accounts in terms of functions, programmes, activities, and projects, the purpose of financial control and accountability is achieved better through itemwise control over expenditure facilitated by objectwise classification.

A revised accounting structure introduced by the Government of India from April 1974[5], attempts to serve the purposes of management as well as the requirement of financial control and accountability. Under this scheme, a five-tier classification has been adopted, namely, sectoral, major head, minor head, sub-head, and detailed heads of account. Sectoral classification has grouped the functions of government into three sectors, namely, general services, social and community services, and economic services.

General services include services indispensable to the existence of an organised state, such as police, defence, external affairs, tax collection, district administration, fire protection, etc. This sector is sub-divided into six sub-sectors, namely: (*i*) organs of state (parliament, head of state, judiciary, audit, council of ministers and elections), (*ii*) fiscal services (agencies for collection of taxes), (*iii*) interest payments and debt services, (*iv*) administrative services, such as public service commission, district administration, police, jails etc., (*v*) pensions and miscellaneous general services, and (*vi*) defence services. The social and community services sector covers programmes and activities relating to the provision of basic social services to consumers, such as education, medical relief, housing, socal security and welfare, and services required for community living, such as public health, urban development, broadcasting, information and publicity. The economic services sector includes programmes and activities in the fields of production, distribution, trade, regulation, etc. This sector is sub-divided into seven sub-sectors, (*i*) general economic services (foreign trade and export promotion); (*ii*) agriculture and allied services (agriculture, cooperation, planning, statistics, etc.), minor irrigation, fisheries, forests, soil conservation, dairy development, animal husbandry, etc.; (*iii*) industry and minerals (large and medium industries, village and small industries, mines and minerals); (*iv*) water and power development; (*v*) transport and communications (ports, light house and shipping, civil aviation, roads and bridges, tourism, etc.); (*vi*) railways; and (*vii*) posts and telegraphs.

There is also a fourth sector in the classification which is called

[5]This accounting structure was introduced to implement the recommendations of the team on reforms in the structure of budget and accounts (referred to earlier in this article).

'grants-in-aid and contributions'. This sector is meant to record transactions pertaining to the transfer of resources in the form of grants-in-aid from the Centre to the States and Union Territories, and from the government to the local bodies and panchayati raj institutions.

In the new scheme of accounts, a major head is assigned to each function, and a minor head is allotted to each programme[6]. Under each minor head, there would be sub-heads assigned to activities/schemes/organisations covered by the programme. Major and minor heads classification is common to the Union, States and Union Territories Governments. These authorities, however, have flexibility in adopting sub-heads to suit their requirements. Also, a list of standard objects of expenditure has been suggested for use by these authorities.[7]

Under the new system, the object classification has been retained and placed under the last tier. It is meant to provide for itemwise control over expenditure, and to ensure financial control and accountability. Its purpose is also to furnish the basis for estimating the fund requirements for each activity and programme.

The revised classification of accounts established adequate links between budget and account heads and the plan heads of development[8] This has facilitated obtaining information of progressive expenditure on plan programmes and projects. The new classification has also enabled bringing together under the appropriate function (major head) and programme (minor head) all expenditures on that function or programme irrespective of the organisation administering the function or the programme. The same applies in the case of an activity sub-head) also, all the expenditure on which can be brought together by operating on the same sub-head as prescribed for that activity. The revised system of accounts has provided the necessary facility for monitoring and analysis of expenditure on programmes, activities, and projects, to aid management function.

[6]For instance, 'Agriculture' being a function, has been assigned a major head, and 'Agricultural Farms' which is a programme under it has been allotted a minor head.

[7]The list includes the following standard objects of expenditure :

(1) salaries, (2) wages, (3) travel expenses, (4) office expenses, (5) payments for professional and special services, (6) rents, rates and taxes/royalty, (7) publications, (8) advertising, sales and publicity expenses, (9) grants-in-aid/contributions/subsidies, (10) scholarships and stipends, (11) hospitality expenses/sumptuary allowances, etc., (12) secret service expenses, (13) major works, (14) minor works, (15) machinery and equipment/tools and plants, (16) motor vehicles, (17) maintenance, (18) investments/loans, (19) materials and supplies, (20) interest/dividend, (21) pensions/gratuities, (22) depreciation, (23) inter account transfers, (24) writes-off/losses, (25) suspense, (26) other charges, (27) diet charges, (28) live stock.

[8]For instance, 'cooperation' has been assigned a major head in the revised accounts classification to conform to a similar plan head of development.

The principle adopted in the new accounting classification is that all expenditures on a function, programme or activity should be recorded under the appropriate major, minor or sub-head. This should be done irrespective of the department or organisation administering the function, programme or activity. For example, expenditure on public works including construction and maintenance of residential and non-residential buildings and roads and bridges is to be accounted for under different major heads, both in the revenue and capital sections. Expenditure on government residential buildings, including maintenance and repairs and construction, is to be recorded under the major head 'housing' or 'capital outlay on housing', as the case may be, in the sector 'social and community services'. Expenditure on construction and maintenance and repairs of 'roads and bridges' is to be accounted for under the head 'roads and bridges' or 'capital outlay on roads and bridges' as the case may be, in the sector 'economic services' under the sub-sector 'transport and communications'.

Non-residential buildings have been classified into two categories : (*i*) administrative offices and general purpose buildings, and (*ii*) buildings for functional purposes, like schools, colleges, hospitals, etc. Expenditure on construction work of the first category is to be accounted for under the major head 'public works' or 'capital outlay on public works' as the case may be, in the sector 'general services'. Expenditure on construction works of the second category, if it relates to a function included in the sector 'general services' is also to be accounted for under the major head 'public works' or 'capital outlay on public works' as the case may be. Other expenditure on construction works of the second category is to be recorded under the functional major head relevant to the purpose of the building in the sector 'social and community services', or 'economic services', as the case may be. However, it has been provided that expenditure on maintenance and repairs of all buildings, namely, administrative offices and general purpose buildings and functional buildings, is to be accounted for under the major head 'public works' in the sector 'general services'.

The revised classification of accounts has, thus, facilitated monitoring and analysis of expenditure on functions, programmes, activities and projects, and the introduction and operation of a system of performance budgeting.

MANAGEMENT ACCOUNTING

The revised classification of accounts and the other financial reforms alrcady completed by the Governmeat of India, like separation of accounts from audit and departmentalisation of accounting function, integrated financial adviser scheme, etc., should facilitate introduction

of management accounting in ministries/departments to support the system of performance budgeting. As stated in the United Nations' publication :

> Accounting should provide information on work done at every stage with reference to the resources used and costs incurred in doing it. It should provide promptly accurate and complete data for administrative control over the execution of the budget plan. A logical corollary of this is the integration of administrative and accounting responsibilities in the operating agencies. The separation of administrative and accounting responsibilities may often prevent an effective control over the progress of expenditure.[9]

The recently introduced scheme of departmentalisation of accounts should provide a better support both for ensuring a sound system of exchequer control and for serving the needs of management at various levels. These reforms need to be taken advantage of for successfully operating a scheme of performance budgeting.

The removal of externality of accounts and their departmentalisation in the ministries/departments is expected to lead to prompt payment of personal claims like salaries, travelling allowances, etc., and better maintenance of provident fund accounts, resulting in greater employee satisfaction. It is also likely to yield benefits by enhancing clientele satisfaction by arranging speedy payments through the pay and accounts offices. The compilation of accounts is expected to be relatively quicker. In fact, a sound system of financial management is made possible by providing a speedy and continuous flow of accounting data. However, the departmentalisation of accounts and the taking over of full responsibility by the administrative ministries/departments for the compilation of their accounts provide only the necessary facility and a basis for the development of management accounting system. A number of other measures are also needed for the installation of an effective system of management accounting.

An efficient accounting system is essential for monitoring and analysis of expenditure. The speed and accuracy with which accounts are prepared are the necessary ingredients for the accounts information to prove useful to management for various purposes. Also, accounting information needs to be presented in different forms to cater to the requirements of management at various levels. Management accounting is concerned with that type of information which can be useful for management. The emphasis is laid on the usefulness of information in serving the needs and purposes of management.

[9]Untited Nations, *Government Budgeting and Economic Planning in Developing Countries*, New York, UN Publication, 1966, p. 12.

Management accounting should generate information which can be helpful in solving management problems. Management implies planning which includes forecasting and budgeting. It also involves decision-making. Further, it implies control including communication, motivation and appraisal. The field of management accountancy, therefore, has to be as wide as management itself. It has to deal with the application of techniques like capital budgeting, project appraisal, budgetary control, costing, standard costing, break-even analysis, inventory management, etc., for generating necessary information to aid management function.

Management accounting, in fact, encompasses financial accounting, cost accounting, and all aspects of financial management. It also involves supplementing the accounting information with other data not reflected in the accounts. The additional information requirements may relate to commitments made, cost escalation, physical accomplishments, etc. In a system of management accounting, therefore, information would have to be collected in addition to what is available from accounts, to help management in its various tasks.

A management accounting system in its true sense should provide the necessary support to different levels of management in the efficient discharge of their functions. It should enable timely availability of accounts information for a systematic and continuous review of the progress of expenditure as related to the budgeted funds and the planned tasks. A sound system of management accounting would facilitate an efficient working of a scheme of performance budgeting. It would also enable meaningful review and evaluation of performance.

Management accounting, therefore, in broad terms, may be said to be that aspect of accounting which facilitates efficient and economical management of various tasks in the organisation by providing the various levels of management with relevant and timely information concerning their specific needs. In this context, importance needs to be attached to devising a right format of reports, determining frequency and time-lag of data collection, and creating proper channels of reporting and data flow. The system should also provide for channels to reach feed-back information to operating levels, necessary for their efficient functioning. An efficient management information system is, therefore, a nccessary adjunct of a sound system of management accounting.

It is not possible to design any standard system of management accounting which may be applicable to all types of governmental organisation. It is necessary to evolve such a system for each department so as to suit its specific management needs. The requirements of different departments for management purposes would vary depending upon their respective functions and organisational structure. Even

within the same department, management accounting system would need to be reviewed from time to time to conform to the changing requirements of the organisation.

An advisory committee has been appointed by the Government of India under the chairmanship of the Finance Minister, with the Controller General of Accounts as the convener,[10] to consider and recommend management accountancy concepts to suit the requirements of different ministries/departments. The committee is also required to make recommendations regarding the management information system necessary to be developed for the purpose. The resolution[11] appointing the committee recognises that the major objective of departmentalisation of accounts is to improve the financial competence of the ministries and departments and to make accounts an effective tool of management. The committee is also to review the system of exchequer control in the departments and ministries with a view to ensure effective monitoring of expenditure in relation to provisions in the budget. The committtee's terms of reference further include an evaluation of the system for receipt and payment accounting of the departmentalised accounting organisations of the ministries/departments with a view to assess how far the system and its techniques are in consonance with the principles of management accounting, and to suggest necessary improvements.

The advisory committee has selected three ministries of the Government of India for a detailed study of the application of management accounting techniques, and for developing suitable management information systems. It has constituted a sub-committee to design suitable systems for these ministries in consultation with the experts of the ministries concerned. The three ministries chosen are: the Ministry of Agriculture, the Ministry of Works and Housing, and the Ministry of Chemicals and Fertilizers. These have been selected because they represent three typical ways in which government policies and programmes are implemented. The Ministry of Works and Housing executes a large number of programmes directly or through its subordinate formations.[12] The Ministry of Agriculture presents another type in whose case the programmes are mainly executed through the state governments. The programmes of the Ministry of Chemicals and Fertilisers are

[10]The members of the committee include, among others: Finance Secretary, Secretary (Expenditure), Secretary (Industrial Development), Additional Secretary (Department of Personnel and Administrative Reforms), Chief Cost Accounts Officer (Ministry of Finance).

[11]Government of India, Ministry of Finance (Department of Expenditure), *Resolution No. 2(96)/76 Special Cell*, dated the 1st November, 1976.

[12]There are of course programmes executed through the public sector undertakings functioning under the adminstrative control of the Ministry, and also those executed through the agencies of state governments.

mainly executed through a number of public sector undertakings functioning under its administrative control. It is thought that these studies would provide valuahle experience and knowledge for extending the concept of management accountancy to other ministries/departments of the Government of India.

A basic necessity, however, remains and that is, accounts should be maintained and compiled departmentally with adequate speed, accuracy and detail to cater to the diverse needs of different levels of management in the organisation. Any system of accounting would have merit only to the extent that it serves the various management objectives. The organisational set-up created for accounting and finance functions would also have merit to the extent that it serves the purposes of management for achieving the objectives of the department.

The scheme of Integrated Financial Adviser (IFA) introduced by the Government of India in October 1975 intends to improve the competence of the departments in the field of financial management. The IFA who has been made a part of the administrative ministry/department is required to assist the administrative secretary and other senior officers in the planning, programming, budgeting, monitoring and evaluation functions of the ministry. The departmentalised accounting organisation has been placed under the charge of the IFA, with the administrative secretary being in overall control as the chief accounting authority. The IFA has also been made responsible for the preparation of the ministry's performance budget and the monitoring of progress of schemes against the budget. It needs hardly to be said that an efficient accounting system is a basic necessity for the successful discharge of the functions of the IFA. A system of management accounting which may be introduced in a department would need to be built on the functions of financial advice and accounting, both of which have been placed under the charge of the IFA.

However, the system as observed in the ministries/departments, generally, is that the payment accounting functions are discharged by a separate subordinate office headed by a Chief Controller of Accounts or Controller of Accounts. According to the organisational arrangements, the accounts set up under the Chief Controller/Controller of Accounts forms one channel of functional hierarchy concerned primarily with payment and accounting work. The other channel of hierarchy is that of financial advisers of different ranks who are responsible for tendering financial advice to the administrative and executive authorities. Both the hierarchical channels function under the direction and control of the IFA. There is a third type of hierarchical channel of administrative, technical and executive officers in different organisational formations. So far as the accounts organisation under the Chief Controller/Controller of Accounts is concerned, it merely transacts payments for the

whole department and discharges other routine functions. It also compiles the accounts for submission to the IFA.

Management accounting, however, does not end with the functions of exchequer control as aided by the set-up of the Chief Controller/Controller of Accounts, and the functions of financial advice as provided by the different levels of financial advisers in the department. It envisages a service role for the accounts and finance personnel to work with administrative and technical officers at different levels to help them in the application of financial management techniques in taking management decisions. This would necessitate suitable integration of accounts and finance set-up with the management side not only at the top level but also at lower levels where significant management decisions are taken. The purpose is to achieve maximum participation of accounting and financial experts at the stage of formulation of proposals and taking of management decisions.

The set-up of the Chief Controller/Controller of Accounts though functioning under the IFA, is not further down integrated with the other levels in the hierarchy of financial advisers. It is, therefore, not involved in facilitating management decisions with the help of application of accounting techniques. Such a situation is antithetical to the concept of management accounting which requires that both the accounting and financial experts should participate in helping management decision-making at different levels in order to facilitate economical and efficient functioning of the organisation. To serve these purposes, the integration of accounting and finance functions would need to be effected not only at the level of the IFA but also at the decision-making levels below.

SOME OTHER ISSUES

The departmentalisation of accounts should result in a timely flow of accounting and financial information to management at all levels. It should enable better planning, programming, budgeting, review of expenditure, and exercise of control by the management. It should also facilitate the management's making 'on course corrections' which may become necessary. There is, however, no need for maintaining duplicate accounts by the administrative authorities, which are reconciled with the accounts prepared in the departmental accounting organisation headed by the Chief Controller/Controller of Accounts. If the accounting set-up is fully integrated at different levels with the financial advisers' hierarchy and also with the administrative and executive authorities in the ministry/department, there should be no need for maintaining duplicate accounts by the administrative authorities.

There are certain constraints to be recognised in developing a system of management accounting to support a successful working of

the scheme of performance budgeting. Government accounting is done on cash basis which makes it difficult to know the cost assignable to an activity. This creates problems in the application of cost control techniques. Also, the present structure of financial accounts is not adequate to serve the purposes af management accounting. The accounts classification is not designed to relate to cost centres. Hence it is difficult to allocate cost to a responsibility centre and to evaluate actual cost against standard cost. It is recognised that the new classification of accounts in terms of functions, programmes and activities has considerably helped monitoring and analysis of expenditure, and relating expenditure on a programme or activity with its physical accomplishments. However, the classification needs to be improved further to provide for subsidiary set of accounts to correspond to cost centres, and to facilitate responsibility accounting.

It may be concluded that the financial reforms introduced recently by the Government of India, namely, the revised accounting structure, the departmentalisation of accounts, the integrated financial adviser scheme, the delegation of enhanced financial powers to administrative ministries/departments, etc , are all calculated to facilitate introduction of management accounting in government to support the system of performance budgeting. The process of reforms, however, needs to be carried forward to effect further improvements, necessary to achieve the desired results. These pertain to supporting the new accounting structure with a subsidiary set of accounts to enable responsibility accounting, designing suitable information systems for different administrative authorities and executing agencies, integration of accounting and finance functions at various levels to provide the necessary support to the administrative and technical officials in their decision-making functions, etc. The efforts begun already towards introduction of management accounting in government, supplemented by other measures necessary to be undertaken, as discussed here, should greatly facilitate operation of a system of performance budgeting.

Rationale of the Indian Financial Year*

K.L Handa

THE ADMINISTRATIVE Reforms Commissions† in their report on Finance, Accounts and Audit have recommended revision of our financial year. This change has been advocated by a body especially constituted for the purpose of suggesting reforms in the public administration of the country. It is not, however, for the first time that such an issue has come up for consideration before the Government of India. This topic has been a subject of controversy for over a century. At different times, different suggestions have been made by different parties. In this article, an attempt has been made to trace the history of the controversy for a change in the financial year. Pros and cons of the various alternatives suggested from time to time have also been discussed. Further, efforts have been made to analyse the implications of discarding the present financial year, with a view to arriving at a balanced and well-considered conclusion.

HISTORICAL PERSPECTIVE

Pre-Independence Period

The rationale of our present financial year has been a subject of debate ever since it was adopted by the Government of India in 1866.‡ In 1869, at the instance of the Secretary of State, the question of

*From *Indian Journal of Public Administration*, Vol. XVI, No. 9, 1970, pp. 220-33.
The Author is grateful to Prof. M.J.K. Thavaraj, Head of the Financial Management Unit, IIPA, for the highly useful discussions he has had with him on the subject. The responsibility for the views expressed is, however, that of the author only.

†The Administrative Reforms Commission was set up through a Government Resolution dated January 5, 1966, to examine the public administration of the country and to make recommendations for reforms and reorganization where necessary.

‡Till then the financial year followed by the Government of India commenced on 1st May and ended on 30th of April. This was probably to suit the commercial considerations of the time when the commencement of the South-West monsoon would bring to a close, on the 30th of April, the shipping season in India. In their report of the 7th of September, 1864, the Commissioners of Inquiry into Indian Accounts considered, *inter alia*, the question of fixing a suitable date for the commencement of the Indian financial year. In addition to the official budget year,

(Continued on next page)

making the financial year coterminous with the calendar year came up for consideration before the Government of India. In view of the anticipated inconveniences and difficulties involved in such a change, the government decided against any revision of the financial year. The question of a change was mooted again by Welby Commission* in 1900 and by Maharaja of Darbhanga in 1908. On both the occasions, the Government of India decided to retain the *status quo*.

The issue was raised again in 1914 by Chamberlain Commission†. While referring to the difficulties of accurate budgeting in India, the Commission pointed out that the then existing financial year was not a suitable period for preparing budget estimates. It suggested that the financial year should commence on the 1st of November or the 1st of January. No action could, however, be taken by the Government of India on the recommendation of Chamberlain Commission owing to outbreak of World War I in 1914. The Government, therefore, postponed consideration of the matter. Later, in 1921 the question of revision of the financial year was raised by Sir Dinshaw Wacha who suggested calendar year for adoption as the official budget year‡, This time the Government of India referred the matter to Provincial Governments, the Chambers of Commerce and some other professional bodies in the country to elicit their views and suggestions.

While an overwhelming majority of Provincial Governments were opposed to any revision of the financial year, the commercial opinion in the country was divided on the issue. After considering the various

(*Contd. from previous page*)
there were at that time a number of other financial years being followed by various sections of the community in India. The Bengal Year commenced in the middle of April, the Fusli Year commenced around the 10th of June, the Madras Fusli Year commenced around the 1st of July and besides, there were some other traditional years. Some of the princely states had their own budget years, *e.g.*, Travancore-Cochin had the Malyalam Year commencing around August/September and Hyderabad the Fusli Year commencing around the 1st of October. Also, the calendar year and the British practice of following a budget year from April 1 to March 31, were known. However, the consideration of having uniformity between the Indian and British Accounts weighed heavily with the Commissioners of Inquiry. They also favoured fixing a financial year which should be for universal adoption throughout India. The Government of India, after considering the various alternatives, decided on a budget year from April 1 to March 31, in conformity with the British practice.

*Royal Commission on the Administration of the Expenditure of India, otherwise known as the Welby Commission.

†Royal Commission on Indian Finance and Currency, popularly known as the Chamberlain Commission.

‡Sir Dinshaw Wacha in his letter of April 15, 1921, addressed to Sir William Winston, Member of the Viceroy's Executive Council, made a suggestion that the Government of India should adopt the calendar year for closing of accounts as was the practice prior to 1861.

viewpoints on the subject, the Government of India decided against any revision of the budget year. Again the question of a change in the financial year became live for a while in March 1926 when Sir Arthur Froom made a suggestion in the Council of State that the budget year should be coterminous with the Calendar year. The Government of India, however, preferred to continue with the existing system. In 1927, the matter was reconsidered at the suggestion of Shri Vidya Sagar Pandya. a member of the Central Legislature, when again the Government of India decided in favour of retaining the existing financial year.

Post Independence Period

The issue of revision of the financial year remained dormant thereafter till it was revived after Independence by some influential persons and public bodies. Shri Yodh Raj, the then Chairman of the Punjab National Bank, suggested in 1952 that the budget year should commence from the 1st of November.* He thought that the results of the south-west monsoon, which was the dominant factor in the economic situation of India, could be gauged better after October. The then Finance Minister of the Government of India, however, felt that there was no sufficient justification for a change. Later, a non-official resolution, brought before the Indian National Congress session at Kalyani in 1954, sought a change in the financial year. It suggested that it might be helpful to have it from 1st of July. Such a financial year, according to the resolution, would provide a better understanding of the effects of south-west monsoon before passing the budget. Also, it would be suitable to the members of legislatures who would find it convenient to tour their constituencies before the rains. The then Prime Minister of India, Shri Jawaharlal Nehru, took personal interest in the matter which was carefully considered by the Union Cabinet. The Cabinet however, came to the conclusion that there was no need for a change in the financial year. The question cropped up again at the meettng of the National Development Council held on the 21st of January, 1956, when the Government explained the case in detail. This development was followed up immediately by the Chief Minister of U.P. who suggested a revision of the financial year to October-September period and made a reference on the subject to the Union Finance Minister in May 1956. The Chief Ministers of West Bengal and Kerala, who also wanted a change in the budget year, raised the issue in 1968. They wanted the year to commence from the 1st of October. The whole matter, therefore, was reconsidered by the

*Shri Yodh Raj made this suggestion in his speech accompanying the balance sheet and profit and loss account of the bank for the year ending 31st December, 1951.

Government of India. As a result, the Union Finance Minister sent a note in May 1958 to all Ministers of Finance in the States, discussing the matter in all its aspects and suggesting that in view of the anticipated difficulties and dislocations involved in such a change, the balance of advantage would be in maintaining the *status quo*.

The Estimates Committee (1957-58) in their 20th report[1] pointed out various defects of the present budget year. According to them, the existing budget period was responsible for the late start of public works. Under the present arrangements, soon after the expenditure sanctions reached the executing agencies, monsoon would break in most parts of the country rendering it difficult to start construction of the budgeted works. These works could be started only after the rains were over. The Estimates Committee recommended a re-examination of this matter and suggested that the various difficulties could be overcome by changing the financial year to commence on the 1st of October. The Government af India, however, thought that the time was not opportune for making a change in the financial year. The matter was subsequently pressed by the Finance Minister of Assam in his reference to the Union Finance Minister in October 1959, when he stressed the need for changing the financial year. He wished the year to commence on the 1st of July. The Union Finance Minister, however, repeated the earlier argument by saying that the time was not opportune for such a change. Four years later, the Panel on Public Works Administration of the Committee on Plan Projects took up the issue in their report[2] and stated that the commencement of the budget year on the 1st of April affected the speed of works because of the monsoon season coming in immediately after the preparatory work for works projects was complete. They recommended that with a view to ensuring a more even distribution of works throughout the year, the budget year should be changed to commence on the 1st of July. This suggestion was submitted for consideration to the Committee on Administration[3] which in February 1964 came to the conclusion that on balance there would be no advantage in making a change in the existing financial year.

Some other critics of the present financial year also say that the delayed execution of public works under the existing system results in rush of expenditure towards the end of the year leading to surrender of sizable funds and stoppage of work at the close of the financial year. They, therefore, advocate suitability of the 1st of July as a date for

[1] *Cf.* Estimates Committee, 1957-58 (Second Lok Sabha), *20th Report on Budgetary Reforms*, New Delhi, Lok Sabha Secretariat, paras 36-40.

[2] Report of the Panel on Public Works Administration, 1963.

[3] Committee on Administration (composed of senior Government of India Officials) Minutes of the Meeting held on the 3rd of February, 1964.

the commencement of the budget year on grounds of efficacy of performance. Under the suggested system, they argue, the expenditure sanctions for works projects would percolate down to the field authorities sometime by August. The executing agencies would take further time for completing the formalities, like calling for tenders, approval of contracts, ordering of stores, purchases, so on and so forth, and would be ready by the end of September for starting the construction. They would thus have utilized the rainy season for going through the various formalities associated with works projects and could launch upon the execution part of it by October. Therefore, on starting the construction, the executing agencies would have uninterrupted working period, extending from October to May or June, at their disposal, which at present is broken up by the existing budget year resulting in dislocation of work.

The Planning Commission in their Draft Outline of the Fourth Five Year Plan have suggested reconsideration of the matter and have observed as follows :

> In this connection, the bearing of the present fiscal year on the annual budget and the annual plan may also be mentioned. The fiscal year ends before the agriculture picture for the preceding year as a whole can be gauged. Work on the annual plan has to be undertaken before the outlook for the *Kharif* harvest can be assessed. It would be useful to examine afresh in the light of present needs suggestions made on several occasions in the past for a review of the existing fiscal year.[4]

Recent Developments

The Administrative Reforms Commission constituted by the Government of India and its Study Team on Financial Administration have, in their reports, dwelt at length on the subject of revision on the Indian financial year. The Study Team, which had the benefit of the views of a good number of senior officers from Union and State Governments and of knowledgeable persons from outside Government, came across sharply divergent views on the issue of changing the financial year. Those in favour of retaining the *status quo* thought that there was no particular advantage to be gained by disturbing the existing arrangements. Others wanting a change, could not agree on any one alternative date which would best suit Indian conditions. They were, however, unanimous in holding that the budget year adopted should be uniform both for the Union and the States. Different

[4]Planning Commission, *Fourth Five Year Plan—A Draft Outline*, New Delhi, Manager of Publications, Government of India, p. 156.

sections amongst them advocated different dates for the commencement of the financial year, namely, the 1st of July, the 1st of October or the 1st of November, and the 1st of January. After analysing the various suggestions, the Study Team came to the conclusion that none of the solutions offered would reconcile all the criteria mentioned for better budgeting, *i.e.*, the budget having : *(i)* accuracy of revenue estimates, *(ii)* accuracy of expenditure estimates, *(iii)* efficacy of performance, and *(iv)* budget timing to suit convenience of legislators and administrators. The Study Team, therefore, observed :

> Since no one solution reconciles all these, what particular balance of advantage should be regarded as justifying a disturbance of the *status quo* with its attendant disadvantages? We have considered these questions and feel that, if the *status quo* is to be changed, the balance of advantage would lie in favour of 1st October, more especially from the point of view of performance on which we lay emphasis throughout this report.[5]

The administrative Reforms Commission, which subsequently considered the matter was somewhat categorical in their recommendations. They observed as follows:

> The Financial Year starting from the 1st of April is not based on the customs and needs of our Nation. Our economy is still predominantly agricultural and is dependent on the behaviour of the principal monsoon. A realistic financial year should enable a correct assessment of revenue, should also synchronize with a maximum continuous spell of the working season and facilitate an even spread of expenditure. For centuries, people in India have become accustomed to commence their Financial Year on the *Diwali* day. This practice has its roots in their way of life. The business community and other sectors of society start on the *Diwali* day with the feeling that they have finished with the old period of activity and have embarked upon a new one. It is, therefore, appropriate that the commencement of the Financial Year should be related to *Diwali* and, in order to prescribe it in terms of a fixed date, we have recommended that the 1st of November should begin the Financial year.[6]

The Commission also thought that a budget year commencing on

[5]Administrative Reforms Commission, *Report of the Study Team on Financial Administration*, New Delhi, Manager of Publications, Government of India, 1967, p.21.

[6]Administrative Reforms Commission, *Report on Finance, Accounts and Audit*, New Delhi, Manager of Publications, Government of India, 1968, p. (ii).

the 1st of November would be better suited for the transaction of parliamentary business.

Others who advocate the 1st of October or the 1st of November for commencement of the financial year argue that the effect of south-west monsoon which is responsible for over 90 per cent of the total annual rainfall in India would be known by September, providing a good picture of the coming *Kharif* crop. Also, this knowledge would facilitate an intelligent guess of the effects of the rainfall on the *Rabi* crop. A budget commencing on the 1st of October or the 1st of November, therefore, would reflect a realistic picture of the coming agricultural production and of the industrial and commercial activities dependent thereon. Also the government staff engaged in the preparation of budget would find the monsoon months comparatively easier for this type of work than the preceding hot summer months.

The issue of revision of the financial year was also considered by the National Development Council at its meeting held in April 1969. The Council was generally in favour of retaining the *status quo*. The matter was thereafter considered by the Government of India, which decided to continue with the existing financial year.

FINANCIAL YEARS OF SOME OTHER COUNTRIES

It may be of interest to talk at this stage about the financial years followed by various countries of the World. The practice of having the budget year coterminus with the calendar year is followed by :

Algeria, Argentina, Austria, Belgium, Bolivia, Brazil, Bulgaria, Cambodia, Chile, Colombia, Congo, Costa Rica, Cuba, Cyprus. Czechoslovakia, Dominican Republic, Ecuador, El Salvador, Finland, France, Federal Republic of Germany, German Democratic Republic, Greece, Guatemala. Guyana, Honduras, Hungary, Iceland, Indonesia, Jordan, Lebanon, Liberia, Malawi, Malaysia, Mexico, Morocco, Netherlands, Nicaragua, North Korea, North Viet-Nam, Norway, Paraguay, Peoples' Republic of China, Peru, Poland, Portugal, Rumania, Singapore, South Korea, South Viet-Nam, Spain, Syrian Arab Republic, Switzerland, Trinidad and Tobago, Tunisia, Uruguay, U.S.S.R., Venezuela. Western Samoa, and Yugoslavia.

There are other countries which, like India, follow a budget year from 1st of April to 31st of March. These are :

Barbados, Botswana, Canada*, Denmark, Iraq, Ireland, Israel,

*In Canada, the date for commencement of the financial year has undergone successive changes from the 1st of January of the 1st of July. It is now the 1st of April.

Jamaica, Japan, Kuwait, Lesotho, Libiya, Malta, New Zealand, Nigeria, South Africa, Swaziland, and the United Kingdom.

The following are some other countries which follow a budget year from the 1st of July to the 30th of June :

Australia, China, (Taiwan), Ghana, Italy, Kenya, Laos, Mauritius; Norway, Pakistan*, Philippines, Sierra Leone, Sudan, Sweden, Tanzania, Uganda, the United Arab Republic, the United States of America, and Zambia.

There are some countries which have their budget year commencing on the 1st of October. They are :

Burma, Ceylon, Haiti, and Thailand.

There are still some other countries which have different periods for their budget years, namely :

Afghanistan (the 21st of March to the 20th of March); Ethiopia (the 8th of July to the 7th of July), Iran (the 21st of March to the 20th of March), Nepal (the commencement date is around 16th July), Turkey (the 1st of March to the 28th of February), and Saudi Arabia (the 15th of October to the 14th of October),

It is, thus, apparent that the practice regarding the budget year varies widely amongst the various countries of the world. There does not seem to be anything like a principle which can be deduced from the practice in other countries. It appears more a matter of historical development than anything based on definite criteria.

Incidentally, it may be mentioned here that the United Nations Organization has adopted the calendar year for its financial year.

A CRITIQUE OF THE VARIOUS ALTERNATIVES

From the study of the history of suggestions for revision of the financial year, it appears that the Government of India have been favouring the *status quo* all along. On the other hand, suggestions for a change in the budget year have almost been coming up throughout the last century. These suggestions contained a few alternatives for overcoming the difficulties said to be inherent in the present budget

*Pakistan changed its financial year to July-June in 1962. Till then its budget year commenced from the 1st of April like that of India.

period. These alternatives were that the financial year should commence from : (*i*) the 1st of July, (*ii*) either the 1st of October or the 1st of November, and (*iii*) the 1st of January. It may, however, be noted that the advantages claimed in favour of each of these alternatives have been vigorously disputed.

The view that a budget year commencing on the 1st of July would enable to have better knowledge of the prospects of south-west monsoon, has been seriously contested. It is said that in this case the budget would be presented to the legislatures sometimes towards the end of May or in early June. To keep to this timing, the budget will have to be prepared in the months preceding June. It would, thus, not be possible to know the behaviour of the south-west monsoon at the time of preparing the budgets. The south-west monsoon breaks over the Arabian coast about the beginning of June (say in the first week) and reaches West Bengal by about the 10th of June. Other places in Western and Northern India get monsoon rains still later. There is, therefore, hardly any question of gauging the effects of south-west monsoon on *Kharif* crop before presentation of budget. Moreover, the States in southern India, like Tamil Nadu, would have objection to the adoption of any budget year which does not take into account the North East monsoon, extending from October to December, the knowledge of which is important for their revenue estimation. Also, legislators may not relish such a change as otherwise they would have to transact legislative business relating to budget during the hot months of May to July. Moreover, it would mean a lot of inconvenience to the Government staff engaged in the strenuous work of budget preparation because such work in that case would have to be done during the months of April to June—the hottest months over the greater part of the country.

The gains enumerated in commencing the financial year on the 1st of October or the 1st of November have also been disputed. It is maintained that the detailed budget processes would remain the same whatever be the date for the commencement of the budget year. If the financial year starts from the 1st of October, the budget would have to be presented to the legislature a month before, *i.e.*, by the end of August or beginning of September. The work of budget preparation would be carried out in the months still preceding, *i.e.*, July and August. Therefore, at the time of framing the budget, the south-west monsoon would not be over, and the amount of rain yet to fall in the later period would not be known. It would, thus, be comparatively difficult to assess correctly the prospects of *Kharif* crop and to make realistic estimates of revenue. Even if the commencement date for the budget year is pushed by one month to the 1st of November, the position would not be very much different. In this case, the budget

would be presented to legislature towards the end of September and prepared a couple of months before that. Therefore, at the time of formulation of the budget, behaviour of the late monsoon, especially the rains of the crucial month of September. would not be known.

There is another factor militating against the choice of either the 1st of July or the 1st of October or the 1st of November as the commencement date for financial year. A large number of companies have their accounting years coterminous with the calendar year. Many others follow the official budget year (April to March) as their financial year. The existing taxation laws relate the assessment of the present year to the income of a company's current accounting year. Those companies which have already coincided their accounting years with the official budget year find it easier to know about their tax liability at the very start of their accounting year. Many other companies which have their accounting years coterminous with the calendar year come to know of their tax liability soon after the start of their accounting period. If the commencement date for the official budget year is shifted to the 1st of July or the 1st of October or the 1st of November, the corporate sector would remain in suspense for a longer period regarding their tax liability. In such a situation, companies might find it necessary to change their accounting years to synchronize with a change in the official financial year. This would involve lot of complications for the corporate sector.

Those who advocate the 1st of January as the most suitable date for commencement of the budget year argue that under such a system it would be possible to incorporate in the budget complete information about the results *Kharif* crop. Also, bulk of winter rains would have fallen by that time indicating the prospects of *Rabi* crop thereby further facilitating estimation of revenues. It is further argued that since most of the companies have their accounting years starting from the 1st of January, making the official budget year coterminous with the calendar year would be found suitable by the corporate sector. But there are equally strong arguments against adopting the 1st of January as the date of commencement of financial year. It is not correct, it is argued, that such a budget year would allow an accurate assessment of revenues from *Rabi* crop dependent on winter rains extending from October onwards. The budget in this case would be prepared during October and November and presented towards the end of November, by which time the character of winter rains would not be fully known. Such a change would also result in losing a considerable portion of the best working season in communicating expenditure sanctions to the field authorities after the passing of the budget, and a further loss of time by these authorities in completing the preparatory work connected with the execution of the projects. It has further been argued that

such a change would make the budget year end in the middle of busy working season. This may cause dislocation and inconvenience to the Public Works and Survey Departments as such a system would divide their expenditure into two financial years right in the middle of their outdoor operations.

Evaluation

It was a matter of historical development that the present financial year came to be adopted in conformity with the British practice. Whatever may be the rationale behind the British practice* we have to consider the contemporary conditions and needs of our country while thinking of an alternative budget year. The considerations of better predictability of revenues, sound estimation of expenditure, efficacy of performance, convenience of legislators and government staff, etc., are all important. However, we have, at the same time, to keep in view that a revision of the budget year would involve many difficulties and dislocations in the existing arrangements. Prudence, therefore, demands that in whatever we decide and act upon, the balance of advantage should be in our favour.

As is clear from the earlier paragraphs, no one alternative suggested for the commencement of the financial year, *i.e.*, the 1st of July, the 1st of October or the 1st of November and the 1st of January, ensures fulfilment of all the desired criteria, even if such an alternative is considered from the point of view of any one particular State. Considering alone the criterion of predictability of revenues, we find that no single alternative budget year allows the various states a realistic assessment for both *Kharif* and *Rabi* crops. If a particular budget year makes it possible to know about the behaviour of south-west monsoon before framing estimates of revenues, it may not do so for the winter rains leaving the estimates of revenues from *Rabi* crop to a complete guess work. It may be relevant to point out that *Rabi* crop is financially more important for some of the states in northern India.

Whereas the behaviour of monsoon is of vital interest to most of the States, it may not be so for Assam, where rains are relatively

*The earliest available British financial records reveal that till 1751-52 each year's public accounts were made up to September 29 and thereafter till 1800 they were made up to October 10. The Finance Accounts of 1800-1 were prepared up to January 5. In the Year 1832, the annual supply grants began to be voted for the year ending March 31 and the budget was presented for the year up to April 5, 1833. The Finance Accounts were, however, made up to Jannary 5, till 1854. In 1854, the Public Revenue and Consolidated Fund Charges Act directed that the Finance Accounts should in future be made up to 31st March each year. The date of 31st March has si ce then remained as the end of financial year in the United Kingdom.

assured and what concerns the State most is the occurrence of floods both from the point of view of estimating revenues as also framing estimates of expenditure. For such a State, therefore, that budget year might be more suitable which allows sufficient knowledge of the extent of floods (ranging from May to the end of October) for making realistic assessments of revenues and of demands for expenditure for relief and rehabilitation works consequent on the devastation caused by floods. It would, thus, be difficult to reconcile the interests of the various States of India on any one alternative date suggested for the commencement of the budget year. But, for obvious reasons, we must have a uniform financial year for the Union Government and the state governments.

Again, knowledge of the behaviour of monsoon in the estimation of revenues, though important, has assumed a different complexion in the present times. It is true that despite the construction of a number of major and minor irrigation projects, generation and distribution of increasing amounts of electricity for energising tubewells and introduction of fertilizers, the role played by rains is still very important in our agricultural situation. Also, the important bearing the agricultrual production has upon industrial and commercial activities cannot be denied. Nevertheless, we cannot, at the same time, ignore taking cognizance of the dwindling significance of land revenue in state budgets and of the pattern of taxation at the Centre. Also, economic activity is developing more and more around industries other than those agro-based, which account for a good portion of state revenues.

It may be urged that any change in the existing budget year would upset past accounts and vitiate all statistical comparisons. The resulting confusion would necessitate increase in staff to cope up with the extra work. Also, it may become necessary to revise the various codes, manuals, rules and forms which would entail a considerable strain on the administrative machinery. A change in the financial year may also necessitate breaking up of the annual periods of the current Five Year Plan which is likely to result in considerable confusion. The example of the partition of the country, in August 1947, may be cited to indicate how the break-up of one financial year into two accounting periods created such difficulties which took many years to clear. Also, the accounts of a number of states were thrown into confusion at the time of the reorganization of states which took effect in November 1956 during the course of the financial year.

This is, however, not to make out that the problems and difficulties associated with the revision of the financial year are insurmountable. We have had in the recent past the decimal system of coinage and the metric system of weights and measures introduced in our country. The difficulties of the transitional period have been met successfully.

Similarly, it should be possible to overcome the difficulties and dislocations in the accounting, statistical, and administrative fields, which may be caused by a revision of the financial year. But the pertinent question is, whether all the trouble taken would be worth the advantages expected from such a change? The present financial year which has the merit of long usage may not be discarded merely on academic arguments. Instead, account has to be taken of practical considerations. It may be mentioned that accurate budgeting and its efficient execution may not flow only from the period of the budget year. The principles of performance budgeting, if properly observed, may help in curing many of the existing maladies. The system of performance budgeting makes it imperative that the administrative authorities, before preparing the budget estimates, plan their activities efficiently in the light of their organizational goals and objectives. The activities are budgeted not on *ad hoc* basis but on proper phasing and scheduling of work. There exist proper norms yardsticks and standards, evolved on realistic parameters to facilitate framing of estimates. In the budget implementation stage, account is taken not only of the progress of expenditure but also of physical achievements which are systematically reported upon and reviewed for deciding the future course of action. A performance-oriented system of financial control and delegation of powers may also play an important role in timely, economical and efficient execution of projects. Therefore, the present-day difficulties arising because of loose budgeting and inefficient post-budget implementation may not be ascribed to the period of the budget year.

Moreover, in certain respects, the criticism against the present budget year has been overdone. It is not quite correct to say that the existing period of the budget year is entirely responsible for lapse of funds and stoppage of work on the closing of the financial year. It is well known to the executing authorities that provision for works in progress would invariably be made in the budget for the ensuing financial year. There should, therefore, be no question of such works being stoped on the last day of the financial year.

In the case of new schemes, however, it is a matter of administrative efficiency that they are incorporated in the budget after proper preparation and due scrutiny, and expenditure sanctions are conveyed to the concerned authorities expeditiously to enable them to start execution of works without loss of time. If, on the other hand, such schemes are put in the budget without adequate details and without the required prebudget scrutiny, some time is bound to be lost in going through the various formalities of getting expenditure sanctions for starting execution of works. Also, the criticism against the present budget year that it does not permit a realistic assessment of *Kharif* revenues has to be moderated by the fact that it does provide a good

indication of revenues from *Rabi* crop. Regarding the needs of the legislators to tour their constituencies before the rains. it should not be difficult to make adjustments in the existing budget session so as to leave sufficient fair-season period, before the monsoon, free to the legislators to go around in their constituencies.

CONCLUSION

A revision of the present financial year is beset with dislocations in statistical, accounting and administrative fields. Though these difficulties are not insurmountable, the advantages to be gained from any such change may not compensate for all the troubles taken and the problems faced. Moreover, different states of India view differently the suitability of various alternatives to their respective climatic and other conditions. It is not possible to reconcile the interests of all the states to any one alternative budget year. It is, however, accepted by all concerned that we should have a uniform budget year both for the Union and the states. In the circumstances, therefore, the best course to yield optimum results would be to retain the existing financial year.

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